RELIANCE ON THE PRIVATE SECTOR TO MEET THE GOVERNMENT'S NEEDS FOR SUPPLIES, SERVICES, AND CONSTRUCTION

HEARING

BEFORE THE

SUBCOMMITTEE ON FEDERAL EXPENDITURES,
RESEARCH, AND RULES

OF THE

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RELIANCE ON THE PRIVATE SECTOR TO MEET THE GOVERNMENT'S NEEDS FOR SUPPLIES, SERVICES, AND CONSTRUCTION

WEDNESDAY, MAY 19, 1982

U.S. SENATE,
SUBCOMMITTEE ON FEDERAL EXPENDITURES,
RESEARCH, AND RULES,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 3302, Dirksen Senate Office Building, Senator John C. Danforth (chairman of the subcommittee) presiding.

Staff present: B. Reid Detchon, staff director; William B. Montalto, procurement policy counsel; Patricia A. Otto, chief clerk; and Harold C. Gordon, legislative assistant to Senator East.

OPENING STATEMENT OF SENATOR DANFORTH

Senator DANFORTH. The subcommittee convenes today to consider the Federal Government's current policy of relying on the private sector to provide the supplies, services, and construction it needs—through contracting out—instead of meeting those needs through in-house activities. The Government's contracting-out policy is defined in Circular A-76, issued by the Office of Management and Budget. Implementation of the policy is the responsibility of the executive agencies.

The Office of Federal Procurement Policy is now undertaking a revision of OMB Circular A-76 to simplify implementation by the executive agencies. OFPP hopes that simplification will result in even broader implementation of the circular.

But contracting out has also become more controversial as its implementation has been accelerated. More in-house activities—both existing and proposed—are being studied to see if they are candidates for contracting out. Because these changes threaten the jobs of Government employees, contracting out is being perceived as a growing danger in some quarters. Some of our colleagues in the House and Senate are advocating strong limitations on the current policy of contracting out—even a freeze on the contracting out of certain services, for example.

Our first two witnesses today, Senators Hayakawa and East, are strong advocates of reliance on the private sector to fulfill the Government's needs. They have introduced legislation—Senate Joint Resolution 93 and Senate bill 2278—that spells out this policy. We will be considering these measures today. It is important to note that Senator Hayakawa's Subcommittee on Advocacy and the Future of Small Business held a series of hearings last year related to this topic. Many of the problems which his subcommittee uncovered have not been resolved.

We will also hear today from representatives of the administration. Implementation of the contracting-out policy will require the strong support of the administration if it is to overcome the challenges now surfacing. Finally, we will hear from representatives of the private sector—vendors that seek to compete for Government business.

To me it seems obvious that the Government should turn to competitive private enterprise for supplies, services, and construction when the cost would be less than the cost of fulfilling the need inhouse. I look forward to today's testimony on this subject.

Senator Hayakawa, thank you for being with us.

TESTIMONY OF HON. S. I. HAYAKAWA, U.S. SENATOR FROM THE STATE OF CALIFORNIA

Senator **HAYAKAWA.** Thank you, Mr. Chairman. Good morning. I am very grateful for this opportunity to appear before the Senate Governmental Affairs Subcommittee on Federal Expenditures, Research, and Rules in behalf of Senate Joint Resolution 93. I introduced this legislation on June 22, 1981—on behalf of myself and Senators Hatch and Nickles—as a member of the Senate Small Business Committee, although it will affect all businesses in the private sector if enacted.

The need for such legislation came to my attention through a 1980 Small Business Administration task force report on Government competition with the private sector and a 1981 General Accounting Office study on the kinds of work that Federal employees and Federal contractors were performing. The SBA report conservatively estimated that $2.98 billion could be saved annually if the Government relied more on the private sector, and up to $19 billion could flow into the economy each year.

The GAO report, Mr. Chairman, estimated that some 11,000 commercial or industrial activities that cost the taxpayers up to $19 billion each year currently are being performed by the Federal Government. The GAO called on Congress to reaffirm the Government's longstanding policy of relying on the private enterprise system to supply its goods and services. The Office of Management and Budget concurs with this need, and the small business community is looking to Congress to enact similar legislation.

The intent of Senate Joint Resolution 93 and House Joint Resolution 294, introduced in the House of Representatives by Congressman David Dreier of California's 35th District, is forthright and simply stated:

> To clarify and reaffirm that it is the basic policy of the Government of the United States to rely on the competitive private enterprise system to provide needed goods and services.

The resolution does not assign priorities or quotas to Federal agencies. That is better left to the management and procurement specialists. But it is well known that the Federal Government does compete directly with the private sector in such areas as printing and binding, data entry and processing, food service, laundry service, audiovisual production, library services, research, and many other activities. If the $19 billion spent on these services were channeled into the economy, the Government would get the same services at reduced cost; the private sector would benefit by increased business; and Government workers and resources would be freed to concentrate on functions that should be performed by the Government.

Mr. Chairman, we are not insensitive to the apprehension expressed by Federal employees as the Government has carried out contracting-out activities in accordance with executive direction. In planning the series of Small Business Committee hearings which I chaired on Senate Joint Resolution 93, we invited representatives of Federal employees' unions to testify, but they did not accept. The hearing record does include a statement submitted by the International Association of Fire Fighters, AFL–CIO and CLC, objecting to Senate Joint Resolution 93 because it does not exclude fire protection and base security operations from contracting out. A similar exclusion was included in the Department of Defense authorization bill. The amendment passed the Senate on May 6 by 50 to 47.

We held three hearings, Mr. Chairman, on Senate Joint Resolution 93. We heard from many small business witnesses who are victims of direct or indirect competition from their own Government in instances where there is no justifiable rationale for such competition. We also heard from established business organizations such as the U.S. Chamber of Commerce, the National Federation of Independent Business, the Committee on Contracting Out, and others who support Senate Joint Resolution 93 and the need for Congress to provide statutory backbone to a policy that has been inconsistent and, in too many instances, ineffective.

Witnesses recited a litany of legislative efforts to diffuse and weaken the Office of Management and Budget's procurement directive, Circular A–76, which I will not take time to recite. I am sure that you are very familiar with them through the many procurement and oversight hearings your committee has held. I believe, however, that because so many efforts have been made, and are being made to this day, we do need legislation to affirm our national policy to rely on the private sector when possible for goods and services.

That is why I am also an original cosponsor of the Economy in Government Act of 1982 which my colleague Senator John East introduced on March 24, 1982. Senator East will speak in behalf of his bill requiring Federal agencies to obtain needed goods and services from the private sector when feasible.

Mr. Chairman, I shall close my remarks by commending you for giving us an opportunity to speak out on this very important matter. At this time, I would like to give you a copy of the Small Business Committee hearings on Senate Joint Resolution 93 which contains detailed background information and supporting evidence for the need to strengthen the Government's contracting-out procedures.

Also may I recite to you the cosponsors of Senate Joint Resolution 93 as requested: Senators Hatch, Nickles, Jepsen, Andrews, Harry Byrd, Specter, D'Amato, East, Durenberger, Rudman, Boschwitz, Kasten, Murkowski, Symms, Thurmond, Helms, and Denton and Senator Roth, who is chairman of the Governmental Affairs Committee.

Thank you very much for this opportunity, Mr. Chairman.

Senator DANFORTH. Thank you, Senator Hayakawa. I would think that the businesses which would gain most from contracting out would tend to be small businesses.

Senator HAYAKAWA. That would be my belief, too, sir.

Senator DANFORTH. Also it would be a tremendous opportunity for minority businesses.

Senator HAYAKAWA. It is, indeed.

Senator DANFORTH. I think that is the case right now, is it not, with respect to Government contracts—it tends to be small businesses and minority businesses which have taken advantage of the opportunity to do business with the Government?

Senator HAYAKAWA. My impression is that minority contractors often get special opportunities as a result of this, but the assistance given to small businesses is by no means limited to minority businesses.

Senator DANFORTH. What is the basis for the opposition? Is it merely that we've got Government employees working in these areas right now and, therefore, we shouldn't contract out? Is that the sole basis for opposition?

Senator HAYAKAWA. Well, I don't know any other basis, Mr. Chairman. Some things have been going on for years, and if they have been going on for years, it is the general feeling that they should go on for more years or decades or centuries.

Senator DANFORTH. Senator Hayakawa, thank you very much. You are more than welcome to stay if you would like.

Senator HAYAKAWA. Thank you, Mr. Chairman.

Senator DANFORTH. All right, the next witness is Manuel Johnson, Acting Assistant Secretary for Economic Policy, Department of the Treasury.

Mr. JOHNSON. Good morning, Senator Danforth.

TESTIMONY OF MANUEL H. JOHNSON, ACTING ASSISTANT SECRETARY FOR ECONOMIC POLICY, DEPARTMENT OF THE TREASURY

Mr. JOHNSON. I have a study to submit for the record, and I'll pass copies around also.[1]

I'll give a brief summary of the submitted statement and then I'll be happy to answer questions.

Very briefly, this study that I have submitted is authored by a colleague of mine and me on Government contracting and the Government provision of services, and it addresses several questions about the economic efficiency of public versus private provision of services.

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[1] See p. 8.

It starts off by asking what the criteria are for public provision of a particular service, and usually that is determined in an economic sense by whether a service can be financed in the private marketplace or not. And if it cannot be financed, in other words, if the market cannot successfully provide this service in the marketplace, it is regarded as a public good. Therefore, a good or service is considered public based on whether the market can insulate consumers of the service or product from nonpaying customers.

National defense is always used as a primary example of what we call a public good. We can't exclude people from consuming national defense. Therefore, you can't really charge any kind of a reasonable price to make it a profitmaking type of function.

Public goods like national defense are considered to be a clearcut public function. This sort of criteria is usually used to determine whether a good should be publicly or privately provided. But if you look at the records, you find that there are some 20,000 to 22,000 commercial and industrial types of functions currently being provided within the Federal Government, which clearly have competing counterparts in the private sector which are able to exclude third parties from consumption and effectively market-price their service. This comes from evidence or information prepared by the Office of Federal Procurement Policy which shows that annual operating costs of Federal Government commercial and industrial services amount to about $20 billion a year with the actual assets being worth another $20 billion.

If the test for providing public sector services is whether they can be financed in a private marketplace, why do we have all these services in the Federal sector? We do have a public policy that encourages private provision of services and establishes rules for determining efficiency. In the executive branch, the Office of Management and Budget has Circular A-76 which lays out the criteria for comparing cost of public versus private provision of services, and there are several considerations that are made.

The study that I've submitted today looks at the evidence from comparing the cost of providing a service in the public sector versus the private sector and finds that in every case there was a relative cost advantage in the private sector for providing commercial and industrial services. The reason why, we find, is basically the incentive structure that exists between the public and private sectors.

In the private sector, the bottom line in terms of incentives was the profit motive; therefore, in order to earn profits in a competitive industry, providers of a service had to be as efficient as possible in terms of reducing costs which increase profit margins.

There are all kinds of distortions of the pure market, but basically as long as profit is required to survive in the marketplace, there are strong incentives for cost reduction.

However, in the public sector, we found that the incentives are perverse in the sense that the incentives to public sector managers who provide competing types of services are such that they're not directly related to quality or the efficiency of the service being provided. In other words, the incentives for public sector managers are to increase their salaries and the perquisites of office. These incentives are in no way tied to the quality or the efficiency of the service being provided. They simply come from budget appropriations, and the motive is to maximize budget and appropriations rather than provide quality service at low cost.

In looking at all of these services across the board, we find that you can make a generalization about public versus private provision of services. In the study that I've submitted we've called this the bureaucratic rule of two, which says that the cost differential, on average, associated with public versus private provision of services is two to one in favor of private provision.

In other words, of all the cases that we looked at, it is twice as costly to provide a service in the public sector that is also offered in the private sector. Therefore, a strong case can be made for contracting out of commercial and industrial services to the private sector at a cost savings of almost 50 percent on the average.

That basically sums up the submitted statement, and I'll be happy to answer any questions.

Senator DANFORTH. Does the administration favor legislation?

Mr. JOHNSON. I can't speak for the administration today on that. I don't think they've really addressed this situation in terms of legislation. I can only speak to the evidence that I've compiled in studying this particular issue.

However, the Office of Management and Budget has certainly focused on Circular A-76 and is giving much more emphasis to cost comparisons and is favoring the contracting-out process. Whether they favor legislation or not, I really can't say.

Senator DANFORTH. Do you know if anybody will be prepared to say at any time in the foreseeable future?

Mr. JOHNSON. Yes, I would think that probably members from the Office of Management and Budget, and even the Treasury Department, at a later date might be able to comment on that. This particular issue has not been brought up before any of the cabinet councils in the administration, but I do foresee it on the agenda at some later date.

Senator DANFORTH. You say that, as a general rule, it is approximately twice as costly for the Government itself to provide services or goods as opposed to contracting out?

Mr. JOHNSON. Yes, as a general rule, and the cost differentials vary dramatically depending on the types of services, but it averages out to almost two to one.

Some examples of extreme situations are in Federal Government ship repair, where you have naval ship repair costing as much as 58 times more than a comparable private sector merchant marine ship, which is simply a support ship such as a tanker or something like that.

To be specific, I think in the case of main feed pumps in tanker support vessels, the maintenance cost differential for naval oilers is $32,000 whereas for a commercial tanker it runs $618. That's just one of the extreme examples.

The average cost differential per ship repair, though, probably runs around 20 to 1.

Senator DANFORTH. Senator Hayakawa, when he testified, stated that the SBA report conservatively estimated $2.98 billion could be saved annually if the Government relied more on the private sector. And he further said that the GAO report estimated that some 11,000 commercial or industrial activities which cost taxpayers almost $19 billion each year currently are being performed by the Federal Government.

If it is half as expensive to contract out, that would indicate a savings of about $9 billion as opposed to the SBA's figure of about $3 billion. But do you think it would be fair to say that if we systematically pursued contracting out, we might save somewhere in the neighborhood of $3 billion to maybe $9 billion? Do you think that's true?

Mr. JOHNSON. I think that is a reasonable ballpark figure of what the savings would be. The fact is that there are about 20 billion dollars' worth of commercial/industrial services being provided in the Federal sector. Whether you could reasonably contract out all of that, I don't know.

A large part of that is in the defense sector, and even though a lot of that is not really national defense related, there is a clause in Circular A-76 that protects commercial/industrial activities that have national defense purposes. It may be difficult to end up with some of that being contracted out.

But I would say that a real concentration on the contracting-out issue could lead to between 3 to 5 billion dollars' worth of saving.

Senator DANFORTH. This isn't a matter of just passing a law one day and saying we are going to contract out. It really is the whole process, isn't that so?

Mr. JOHNSON. That's right.

Senator DANFORTH. Isn't it really a matter of how the Government does the public's business on a year-in, year-out basis?

Mr. JOHNSON. It is a process. I think that there is enough evidence to show, though, on the record that you can almost generalize in terms of the relative efficiency of public versus private sector provision, and that legislation could be needed. I don't know. I think that it depends on how much of an effort the Government puts on the contracting-out process. I think that the economics are clearly there, but it is something that has to be monitored continuously. It is going to be sort of an administrative process.

Senator DANFORTH. Mr. Johnson, thank you very much.

Mr. JOHNSON. Thank you, Senator.

[The study submitted by Mr. Johnson follows:]

STUDY SUBMITTED FOR THE RECORD BY MANUEL H. JOHNSON, ACTING ASSISTANT SECRETARY OF THE TREASURY DEPARTMENT OF THE UNITED STATES

Abstract

This article investigates an alternative which permits tax reduction without significant effects on the output of public services: private-sector production of public services. Empirical evidence on a wide variety of services is examined: refuse collection, fire protection, debt collection, health care and hospital services, claims processing, ship repair, and the operation of utilities and airline services. The evidence indicates that the economies achievable are real and not hypothetical; the private-sector provision of public services offers an excellent opportunity for tax reduction without sacrificing services.

TAX REDUCTION WITHOUT SACRIFICE: PRIVATE-SECTOR PRODUCTION OF PUBLIC SERVICES

JAMES T. BENNETT
MANUEL H. JOHNSON
George Mason University

I. INTRODUCTION

There is considerable evidence that taxpayers are dissatisfied with either the current level of taxation or with the level of public services provided by all levels of government in relation to taxes. By June 1979, 30 states (of the required 34) had adopted resolutions calling for a convention to enact a balanced budget amendment to the federal Constitution. In addition to California, where limitations on property taxes were approved by a wide majority of voters in June 1978, at least six other states have adopted measures which limit either government spending or taxes, and similar resolutions are pending elsewhere. At the local level, the defeat of school bond issues and other spending

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AUTHORS' NOTE: The authors gratefully acknowledge the helpful suggestions of David Davies and the research assistance of Peter Germanis and Donald Leavens. The usual caveats apply.

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proposals by voters also lends credence to the notion of a "taxpayer revolt." To some extent, higher taxes are the result of inflation, for the rising prices of goods and services and the appreciation of real property increases the tax taken from income as sales taxes and property taxes rise. Further, as incomes rise, the typically progressive federal and state income taxes increase more rapidly than income. The taxpayer's frustration results not only from a higher level of taxation, but also from the fact that there is often little, if any, commensurate increase in public services. This frustration may be the basic cause of the taxpayer revolt or the tax limitation movement.

The principal argument offered by opponents of tax limitation measures is that mandated reductions in government spending would produce serious economic and social dislocations because of the associated cuts required in public services. Even in the case of California, where substantial tax cuts were imposed, it is argued that serious consequences were averted only by the offsetting allocation of a large state budget surplus to local governments. The ideal state would be lower taxes without reductions in public services; however, this state can be achieved only by increasing substantially the economic efficiency of the production of public goods so that the same level of outputs can be produced at lower costs and the savings returned to the taxpayer in the form of tax reductions.

This article investigates a simple alternative which can achieve the goals of a substantial reduction in the tax burden without requiring reductions in the level of public services. The basic thesis is that the production of public services by private firms would result in significant economies so that, even if output were held constant, taxes could be cut substantially. As shown in Section II, private-sector, relative to public-sector, economies exist for two reasons. First, whereas public enterprises generally cannot achieve scale economies because markets are limited to political jurisdictions, private firms are not constrained by such boundaries which may be the result of some historical accident. Second, political firms are insulated from the competitive pressures of the marketplace, and managers in the public sector have incentive structures which differ markedly from those of the manager in profit-seeking firms. Utility maximizing behavior for public- and private-sector managers is also discussed in Section II. Essentially, it can be shown that, in the private sector, the self-interest of the manager is enhanced by increasing economic efficiency; this is not the case in the public sector.

From an economic perspective, public goods and services have externalities or spillover effects associated with their consumption. However, consumption externalities do not imply that there are spillovers associated with the production of these goods and services. Therefore, even if a public service is publicly financed, it does not follow that the service must or should be publicly produced. There are numerous examples of public production of goods and services which are also produced by the private sector—for example, at the local level of government, refuse collection, education, and fire protection are commonly provided by the public sector; at the state level, education and highway maintenance; at the federal level, ship repair and debt collection; all are activities in which private firms are also engaged. In Section III, case studies of a variety of activities are surveyed in order to assess the relative efficiency of the public sector compared with the private sector. Overall, the public/private cost comparisons indicate that private production of public services, consistent with the model developed in Section II, is far more efficient than public production. The last section contains conclusions and policy implications.

II. ORGANIZATIONAL STRUCTURE AND ECONOMIC EFFICIENCY

There are two important reasons why private firms should produce goods and services more efficiently than public firms. First, the public firm generally serves a given political entity whose geographical boundaries may well have been the result of historical accident rather than a conscious economic decision. Therefore, the size or scale of operation of the public firm may not be optimal. Second, the public firm typically enjoys a monopoly market for its services which is created by government fiat. In such an economic environment, the public enterprise is largely isolated from the competitive forces of the marketplace, and market incentives for efficiency are absent. Moreover, a vastly different incentive structure exists for the manager of the private firm vis-à-vis the manager of the public firm, and it can be shown that the incentive structure in the public sector hinders rather than enhances the efficient provision of goods and services. Each of these issues is discussed in detail below.

THE OPTIMAL SCALE OF OPERATIONS

In contrast to the public enterprise, the private firm may adjust its scale of operations to exploit fully any economies of scale or to avoid any diseconomies which may be present in the provision of a particular good or service, because private enterprise generally is not constrained by political boundaries.[1] The public firm often serves all residents of the political jurisdiction so that the scale of operation is not determined by economic criteria, but by political considerations. If diseconomies exist, the political unit may be so large that an inefficient scale of operation is required. Alternatively, if economies of scale are present so that unit costs decline as size increases, the jurisdiction may be too small to capture the economic benefits of optimal size.

Even if the political entity is of ideal size for the production of a particular good or service, economic efficiency in the production of all services may not be achieved for two reasons. First, all goods and services provided by the government sector are not subject to identical scale economies. Hirsch (1973: 322) showed from empirical evidence that urban public services exhibit different scale economies, as summarized in Table 1. Thus, given Hirsch's findings, the efficient provision of one service may imply the inefficient provision of another. Second, the optimal size for production of any service may differ from the optimal size for finance. These issues have been explored by Richardson (1969: 202-203), who concluded that

TABLE 1
Presence or Absence of Economies of Scale in Various Urban Public Services

Horizontally integrated services:	
Police	No
Primary and secondary education	No
Refuse collection	No
High school education	Uncertain
Hospitals	Uncertain
Fire	Yes, but very minor
Vertically integrated:	
Water	Yes
Sewage	Yes
Electricity	Yes

SOURCE: Hirsch (1973: 322).

> there is no single size of urban government unit that is optimal for the satisfaction of all public wants. Some functions are best performed by large units, others by much smaller units. For this reason, a multilevel system of government will be much more efficient than a single unit system. An ideal theoretical solution might be to have a different structure of urban government boundaries for the provision of each public service, but in practice the cumbersomeness of overlapping units, the interdependence of investment decisions in different public services and administrative inconvenience would lead to inefficiencies. Moreover, the level of urban government that is optimal for performing a given set of municipal functions may not be of optimal size for financing these services. Even if we could delimit the urban government area that best supplies a public service from the point of view of economic efficiency, this may not be the preferred size when subjective factors such as community participation potential and local identity considerations are allowed for.

Therefore, public production of goods and services is inherently inefficient because economies of scale and finance cannot be realized.

PUBLIC VERSUS PRIVATE INCENTIVES

Even if the scale of operation of the public-sector enterprise were optimal, the private firm would still produce goods and services more efficiently than the public firm because of the differences in the incentive structures between the two types of organizations. As mentioned earlier, the private firm must face the discipline imposed by the market mechanism. A firm which operates inefficiently runs the risk of incurring losses in the short run and being forced from the market by lower-cost competitors in the long run. The public firm, however, is insulated from such competition by a government-granted exclusive franchise. For example, the federal postal system is given exclusive rights in the delivery of certain types of mail and has used its legislatively mandated powers to inhibit competition from the private sector. In other cases, alternatives are available—such as private as opposed to public schools—but the taxpayer often supports the publicly provided service whether it is used or not. Therefore, an individual may not have the option of determining the quantity to be consumed when services are publicly provided. The only alternatives for the taxpayer under these conditions are to either change political jurisdictions (that is, "vote with his feet") or attempt to elect officials who provide government services more efficiently.[2]

Because of the differences in economic environments, the managers of private-sector firms have incentives for efficiency which are vastly different from those in the public sector. The utility function of the private-sector manager differs from the standard treatment in the economic theory of the consumer in that managerial perquisites (for example, travel, expense accounts, and a company-provided car) and profits appear as arguments. Utility is a function of profits because, in the private sector, a manager's performance and prospects for future promotion depend upon the profits his organization obtains. Programs that permit the manager to participate in profits (profit-sharing) are common in the incentive structure of the private sector; therefore, income consists of two components: a fixed salary and a bonus which depends upon profits.

In order to increase utility, the private-sector manager must, ceteris paribus, increase perquisites or profits. However, there is a direct trade-off between perquisites and profits, for each dollar expended on perquisites reduces gross profits by one dollar. Williamson (1963: 1035) observed:

> [The manager] would normally prefer to take . . . emoluments as salary rather than as perquisites of office since, taken as salary, there are no restrictions on the way in which they are spent, while if withdrawn as corporate personal consumption (such as expense accounts, executive services, office suites, etc.), there are specific limitations on the ways these can be enjoyed.

Williamson also noted that there are two reasons why perquisites may be preferred to salary: (1) they provide tax advantages and (2) they are less visible to stockholders and to labor and are less likely to provoke dissatisfaction. Therefore, some level of perquisites will be enjoyed by the manager, but not to the extent that a satisfactory level of profits (and bonus) is jeopardized.

If managerial perquisites are held constant, profits and, therefore, utility may be increased by either reducing the cost of output or by increasing revenue. Revenues can be raised by increasing prices only if demand is price inelastic. However, the more competitive the market in which the firm operates, the greater the elasticity of demand, and, since the quantity demanded is inversely related to price, price increases can result in a loss of sales to competitors. For this reason, in a competitive market the manager is under constant pressure to reduce the cost of production to the absolute minimum—that is, to achieve a high level of economic efficiency. Efficiency permits the private-sector manager to maximize utility by achieving a high level of profits without sacrificing managerial perquisites. Thus, the discipline imposed by the operation of the market system provides inherent incentives for economic efficiency.

In sum, the private-sector manager is motivated by both the "carrot and the stick," in that he is rewarded financially and promoted for reducing costs and increasing profits and may be punished for unsatisfactory performance either by the actions of his superiors (through termination or demotion) or by competition from more efficient firms which may eventually drive the firm from the market. In the case of the government bureaucrat, however, neither the carrot nor the stick operates to encourage efficient performance. As is well known, it is difficult to terminate government employees even for poor performance; the low rates of employee turnover in the public sector relative to the private sector provide empirical evidence in support of this assertion. Moreover, the manager of a government bureau has, at best, only minimal incentives for economic efficiency.

The bureaucratic manager, like his private-sector counterpart, enjoys increasing utility as perquisites of office increase, but there is no trade-off for the bureaucrat between emoluments and pecuniary income. The bureaucrat does not benefit financially from cost reductions since he does not obtain increased income, for the only income available to the bureaucrat (aside from bribes, kickbacks, graft, and corruption) is the fixed salary received from employment. Managerial rank in the public sector is largely a function of the number of employees which the manager supervises; as Tullock (1965: 134) observed, "in most American and European governmental bureaucracies . . . [a bureaucrat] is rewarded . . . for simply increasing the number of inferiors that he supervises."[3]

The budget allocated by the legislative sponsor for the operation of the bureau is exhausted by spending on perquisites of office, salaries of subordinates, and the nonlabor cost of producing the output. If the bureaucrat serves his own interests, he will always spend the entire budget allocated to his bureau. Promotions, prestige, and increases in salary depend upon increasing the number of subordinates which the public-sector manager supervises. An increase in bureau employment, however, requires an increase in the appropriated budget. The bureaucrat would find it difficult to justify budget increases in the next period if the budget in the previous period was not totally expended. For this reason, in federal, state, and local governments, it is commonplace for bureaus to accelerate their procurement activity toward the end of the fiscal year in order to ensure that all allocated funds are spent.

It is true that the bureaucrat can increase his utility by increasing the perquisites of office. Given that the bureau's budget is exhausted in each period, however, increasing the spending for perquisites requires a reduction in the agency's wage bill or a reduction in the nonlabor cost of producing the agency's output. Since utility also depends on the level of employment, there is little incentive to reduce the agency wage bill. As Bennett and Johnson (1979a) showed, however, the bureaucrat, once the agency budget has been established, attempts to shift the cost of agency output to the private sector so that additional funds are available for perquisites. Further, because of the nature of the services produced by the public firm and the budget process itself, there are few benefits to be achieved from reducing the cost of output. More specifically, the services produced by the public firm are typically very labor-intensive—for example, refuse collection, education, and police and fire protection. In addition, in the public sector, "operating" budgets are frequently appropriated independently of "capital" budgets. Thus, the appropriation process itself may inhibit the bureaucrat from making trade-offs between capital equipment and labor services. It might also be noted that one of the nonpecuniary perquisites of bureaucratic management arises from a much lower level of pressure to increase efficiency. Alchian and Demsetz (1972) showed that there is a greater incentive for "shirking" in public than in private enterprise, for the public employee's wealth is not affected by his decisions.

Relative to the private sector, the incentive structure of the bureaucratic manager is perverse. Not only are incentives for economic efficiency largely, if not totally, absent, but every bureaucrat is inherently an empire-builder who seeks to enlarge the size and scope of his agency in order to increase status and salary. Factors other than efficiency and cost minimization motivate the public-sector manager, although some modicum of efficiency must be achieved to avoid reprisals from the agency sponsor. In theory, the elected politicians who appropriate the budget allocation of the bureau maintain control of the bureau's activities and ensure efficient production of the bureau's output. In reality, however, it is difficult or injudicious for the politician to carry out rigorous oversight functions for a number of reasons.

As Downs (1967: 30) noted, an essential characteristic of bureaucracies is that "[there is] no direct way of evaluating their outputs in relation to the costs of the inputs used to make them." For example, how does one measure the output of such activities as education, national defense, police and fire protection, and health care services? In cases where outputs are difficult and costly to measure, inputs such as the number of teachers or students in education or the number of personnel and ships in national defense are used as surrogates for output. The politician, therefore, generally associates increases in inputs funded by budget increases with increases in output.

The self-interest of the politician is also served by a public sector that is growing in employment. In simple terms, the goal of the politician is to remain in office. Public-sector employment offers an attractive means of providing patronage to the politician's supporters. In addition, as Bush and Denzau (1977) showed, government employees have a vested interest in the growth of government and, because of this interest, are very active politically. Relative to the general public, they vote in greater proportion and have a correspondingly disproportionate impact on political decisions.

Finally, the politician generally creates a monopoly for the public-sector firm, and constituents who pay taxes would be greatly displeased by an interruption in service when there are no alternative sources of supply. Voter displeasure might be detrimental to the politician at election time so that there is little incentive to stress cost-cutting efforts which might lead to strikes or work slowdowns by public employees. De Alessi (1974: 7) asserted: "Government firms, particularly those endowed with a politically influential clientele, can survive for long periods, and their managers prosper, in the presence of persistent deficits (let alone economic losses) and grossly inefficient management." The rate of growth of government is, of course, constrained by the growth of tax revenues and deficits. The politician, particularly in an election year, is adverse to voting for higher taxes, but in times of inflation, tax revenues increase automatically as property assessments increase at the local level of government, and the progressive income tax structure increases the "take" of government at the state and federal level.

The effects of the bureaucratic incentive structure have long been recognized. For example, 35 years ago, Ludwig von Mises (1944: 1) began his classic book, *Bureaucracy*, in the following way:

> The terms, *bureaucrat, bureaucratic,* and *bureaucracy* are clearly invectives. Nobody calls himself a bureaucrat or his own methods of management bureaucratic. These words are always applied with an opprobrious connotation. They always imply a disparaging criticism of persons, institutions, or procedures. Nobody doubts that bureaucracy is thoroughly bad and that it should not exist in a perfect world.

Mises' description of the connotation attached to bureaucracy is more accurate than apocryphal. Attitudes toward bureaucracy are based upon the observation that bureaucratic methods are inefficient and wasteful. The incentive structure for the manager of a government bureau described above implies that the private sector should be a much more efficient producer of goods and services than the public sector. Even if the incentive structures were identical, one would expect the private sector to outperform the public sector because private firms can achieve economies of scale, whereas the public enterprise cannot because of political boundaries. Although it is difficult to measure the output of the public sector in absolute terms, it is possible to make relative comparisons between public- and private-sector production costs for the same service.

III. PRIVATE/PUBLIC EFFICIENCY IN THE PRODUCTION OF SERVICES: THE EMPIRICAL EVIDENCE

A number of studies have empirically investigated the relative efficiency of the private vis-à-vis the public sector in the provision of a variety of services including refuse collection, fire protection, debt collection, health care and hospital services, ship repair, and the operation of utilities and airline services. Some of these activities are regulated by government—for example, those of airlines, utilities, and hospitals. Moreover, health facilities are also often regulated through the accreditation process by private associations. Regulation, especially that which guarantees a specific rate of return, reduces the incentives for cost minimization and may also inhibit the firm from achieving an optimal scale of operations. For example, airline routes are often allocated, and utilities must provide service to all users in their service area. Yet, as discussed below, the private sector, despite such restrictions, has been found so consistently more efficient that Borcherding (1977: 62) proposed the "Bureaucratic Rule of Two: removal of an activity from the private to the public sector will double its unit costs of production." The empirical findings on public/private relative efficiency are reviewed briefly for each activity; evidence is then presented on labor intensity and the adoption of technological change in private vis-à-vis public firms.

REFUSE COLLECTION

Refuse collection is of particular interest for three reasons. First, this technologically simple activity, which is carried out at the local level of government by public operations and by private firms as well, illustrates many of the problems associated with making public/private cost comparisons. Second, in contrast to firms which are regulated or constrained to a given service area or route configuration, private garbage firms may seek economies of scale. Third, because there are virtually no economic barriers to entry—large amounts of capital are not required—in the absence of government restrictions on entry, trash collection in the private sector should be fiercely competitive and pressures for cost minimization especially intense. Although these considerations imply that refuse collection should clearly show the superior efficiency of the private sector, the empirical evidence is conflicting.

Hirsch (1965) found no significant differences between public and private costs of residential refuse collection. A study cited by

Spann (1977: 83-85) for communities in Monmouth County, New Jersey, appears to show that the average per capita costs of trash collection are 70% higher when services are provided by the public sector, but these data must be interpreted with caution, for no attempt was made to hold all other factors constant across observations. Kemper and Quigley (1976: 110) concluded from their econometric analysis of garbage collection in various Connecticut jurisdictions that

> collection cost appears to vary systematically with the organization of collection, even after controlling for other factors. Private collection appears to be about thirty percent more expensive than municipal collection, which, in turn, appears to be about twenty-five percent more expensive than contract collection.

The finding of Kemper and Quigley is supported by Stevens (1978: 445), who found that "the competitive arrangement is from 26 percent to 48 percent more costly than the private monopoly arrangements." Stevens' data consisted of observations of 340 public and private firms operating in an equal number of cities. On theoretical grounds, but without supporting empirical evidence, Young (1972: 73) also asserted that municipal contracting with a private firm is less costly than either private or municipal collection of trash. In contrast, Kitchen (1976) reported that private collection of garbage is far less costly than municipal collection in 48 Canadian communities, each with a population in excess of 10,000.

The evidence on the existence of economies of scale is as conflicting as that on the most efficient method of collection. As noted in Table 1, Hirsh believed that economies of scale did not exist, as did Kemper and Quigley (1976: 34); Stevens (1978: 445), however, argued that scale economies are present for large and small firms but not for firms of intermediate size.

Clearly, an explanation which resolves some of the discrepancies among the studies of refuse collection and provides a more satisfying interpretation is needed. A major weakness of all previous studies of private versus public cost of garbage collection is that municipalities are employed as the unit of observation. As is well known, there is little comparability among the budgeting practices of different municipalities because of the lack of rationality in the budgeting of costs by function within individual governmental entities. Indeed, as Kemper and Quigley (1976: 56ff) recognized, an individual municipality may not even be aware of the true cost of municipally provided services: "Although municipalities typically maintain a separate budget and expenditure account for refuse collection, these figures seldom include all of the costs that are properly attributed to that service." From the outset, then, cost comparisons are biased in favor of the municipality. This bias can be sizable; Kemper and Quigley (1976: 57) estimated for fiscal year 1972-1973 that the budget figures for refuse collection for Hartford, Connecticut, underestimated the true cost by 41%, because the costs of vehicle operation and maintenance, interest, and depreciation were not included in the budget. Further, the concept of opportunity cost is virtually unknown in government bureaucracy, and forgone property tax revenues resulting from municipal collection of garbage (which understates the true cost of municipal collection) was estimated to be an additional 2.3 percent of Hartford's budget for trash removal. None of the studies considered the future cost liabilities incurred on behalf of the taxpayer for the pension payments of retiring municipal employees. Pension benefits are substantial (Bahl and Jump, 1974; Jump, 1976; Perham, 1976), and their omission also produces a downward bias in the costs of municipal collection relative to private collection.

Because of the inherent difficulties involved in identifying and assessing the relevant costs of public trash collection in a given municipality and the lack of comparability among various municipalities, a more valid approach is to use the prices charged by private firms in a *single* governmental unit as the basis for comparison with the fees charged by the municipality for public collection. This approach requires that private collection of trash coexist with public collection in the same jurisdiction. Such cases, fortunately, are not rare; Bennett and Johnson (1979b) analyzed refuse service charges for a single jurisdiction in the Virginia suburbs of Washington, D.C., where 29 private firms serve almost the same geographical area as the public enterprise. The empirical findings indicated, after adjustment for frequency of service and for income tax deduction benefits to homeowners, that public service was about twice as costly as private refuse collection.

The existence of a large number of small firms would seem to deny the presence of economies of scale. Other investigators whose empirical analyses support the scale economies argument without exception employ regression analysis as their empirical technique. Economies of scale are indicated by a significant coefficient for a nonlinear-size variable. However, regression coefficients must be interpreted individually on a ceteris paribus basis—that is, all other variables held constant. But in garbage collection firms, ceteris are not necessarily paribus, because wage rates may vary with firm size. Large firms may be unionized and pay union wages, whereas small firms may be family operations with labor contributed by family members. Indeed, Stevens (1978: 443) recognized that "monthly wages of collectors [were] positively correlated with total costs" and, as would be expected, total costs increase with size. In computing scale economies, it is therefore necessary to allow wages to vary with firm size rather than assume this very important component of cost to be held constant. For this reason, the evidence presented thus far on the issue of scale economies is inappropriate.

FIRE PROTECTION

Although fire protection is a public service which is generally produced by public firms that use either volunteers or paid employees, one community—Scottsdale, Arizona—contracts for this service with a private firm. Ahlbrandt (1973), using data for 44 cities and five districts in the state of Washington, estimated the cost of provision of fire service per capita as a function of population, area served, fire insurance rating index, number of personnel, and other variables. The model, estimated with data from cities in Washington, was verified for cities in Arizona by showing that it correctly predicted actual per capita fire protection costs for Arizona cities. For the city of Scottsdale, the model predicted that actual costs per capita would be $7.10 if fire protection were provided by a bureaucratic producer. The private firm serving the city, however, was paid $3.78 per capita, a cost savings of $3.32 per capita, or approximately 47%. Alternatively, if the public sector were to provide the fire protection instead of the private sector, per capita costs could be expected to almost double.

The after-tax profit rate for the private company was regulated not to exceed 7% of gross revenues. Although such regulation might be expected to attenuate incentives to reduce costs, Ahlbrandt (1973: 10) asserted that this was not the case, for

> there is an incentive for the company to minimize costs. Growth is predicated upon being able to maintain current customers and develop new sources of business. If costs are not kept in check, newly formed communities will not have an incentive to purchase the service and existing customers may seek alternative sources of supply. Potential competition exists in the form of the threat of the municipality producing its own service or contracting with another producer.

The fire insurance rating for Scottsdale is no different from that of other comparable cities, which indicates that, although the cost of provision of fire service in Scottsdale is significantly lower, the quality of service provided is comparable. A major cost saving for the private firm is that employees construct the company's equipment. The equipment built in-house lacks the fancy chrome and other accoutrements so typical of the traditional fire engine. The accessories can add thousands of dollars to costs but add nothing to firefighting ability.

DEBT COLLECTION

The federal government is not only the nation's largest debtor, but is also its largest creditor—the General Accounting Office

(1979a: i) reported in 1979 that $118 billion was owed the federal government. The level of receivables is large in absolute terms and rapidly growing, for the amount due the government increased by $15 billion, or 21%, during fiscal year 1977. Like the private sector, the federal government is plagued by nonpayment; the Treasury Department reported that the allowance for bad debts was $3 billion at the end of fiscal year 1976, an increase of 35% over the prior fiscal year. Unlike the private sector, however, the government takes a highly cavalier attitude toward collection. The Comptroller General reported to Congress (U.S. General Accounting Office, 1979a: i-viii) that only three of 12 agencies audited established allowances for uncollectable accounts, and most agencies simply write off debts and make no attempt to collect them. In fact, many debts arise from bureau errors in making overpayments (the Social Security Administration had made excessive payments totaling $1.5 billion as of September 30, 1978). Thus, if these debts were collected, bureaucratic errors in payment would be exposed.

The GAO report (1979a: iii) stated that "[federal government] collection methods are expensive and slow compared with commercial practices and are not cost-effective in dealing with debtors who delay or try to avoid paying." Generally, the government does not seek judgment on debts of less than $600, whereas commercial firms surveyed asserted that it was cost-effective to pursue collection to the point of court judgment for claims as small as $25. The GAO found that one large agency spent an average of $8.72 to pursue collection, but that comparable costs for a commercial firm were less than $3.50 for the same operations. In the private sector, court judgments are normally sought within five months, but the federal government collection process which proceeds to the same point normally takes a year, and frequently much longer. Therefore, by the federal government's own assessment, the bureaucratic debt collection process, when undertaken at all, is far less efficient than its private counterpart. Although government bad debts increase the tax burden and the federal deficit, agencies are now prevented from employing private collection agencies, except when given explicit legislative authority.

HEALTH CARE AND HOSPITALS

Studies of public versus private health care and related issues have been conducted by Frech (1976), Clarkson (1972), and Lindsay (1976). Frech analyzed the performance of profit-seeking and nonprofit firms in processing Medicare claims under contracts from the Social Security Administration. Three measures of performance were used: cost per dollar of claims processed, average processing time in days, and number of errors per $1000 of claims processed. The means and standard deviations (shown in parentheses) are given in Table 2 for each performance measure for the 12 profit-seeking firms and the 66 nonprofit firms in Frech's sample.

As is apparent from the table, nonprofit firms have processing costs that are 45.3% higher, average processing times almost 80% higher, and an error rate 140% greater than profit-seeking firms. In addition, the profit-oriented claims processor has, without exception, a much smaller standard deviation for each of the three performance measures, indicating that the variation among profit-seeking firms is much smaller than among the nonprofit firms. The differences are highly significant statistically.

Although the nonprofit organizations which Frech described are not necessarily governmental entities, the incentive structure is very similar because the profit motive does not operate. Further, on the basis of results obtained from regression analysis, Frech (1976: 151) reported that nonprofit firms operated at an inefficiently low level of scale and concluded that "apparently nonprofit firms not only choose inefficient points on their cost surface, but the entire surface is higher for them." Thus, even though a nonprofit organization may not be limited to a particular scale of operation based upon political considerations, there is no guarantee or incentive for such organizations to operate at optimal size.

Clarkson (1972) investigated differences in operating characteristics and costs of proprietary and nonproprietary (nonprofit private and governmental) hospitals. Based on surveys of general hospitals, he found that nonproprietary hospitals were mor

TABLE 2
Performance Measures for Medicare Claims Processing, by Type of Firm

Performance Measure	Profit-seeking Firms	Nonprofit Firms
Cost per Dollar Processed	$ 0.0715 (0.0178)	$ 0.1039 (0.0331)
Average Processing Time (Days)	18.70 (10.34)	33.59 (19.83)
Errors per $1,000 Processed	0.1844 (0.0717)	0.4426 (0.7576)

SOURCE: Frech (1976: 147).

"bureaucratic" than proprietary hospitals, in that the "nonprofits" were more likely to have a written set of staff regulations, regularly scheduled staff meetings, standing committees on the staff, and restrictions on surgical privileges. Proprietary hospitals were also found less likely to give automatic salary increases to employees.

Clarkson (1972: 378) also provided a comparison of mean weekly wages for 26 occupations for employees of nongovernmental and governmental hospitals in Los Angeles and in San Francisco. In the Los Angeles sample 47% of the nongovernmental hospitals were proprietary and, for 25 of the 26 occupations, the nongovernmental weekly wage was below the weekly wage at governmental hospitals. In some cases, the wage differences were substantial; for example, nursing directors were paid 34% more in governmental hospitals. Only medical record librarians were paid less. None of the governmental hospitals in the San Francisco sample was proprietary, and, in this case, governmental hospitals paid a higher weekly wage for 22 of the 26 occupations. The average weekly wages are significantly higher across occupations in governmental hospitals in the Los Angeles sample but not in the San Francisco sample, which indicates that the wage behavior did not differ statistically between nonproprietary private and governmental hospitals; further, proprietary hospitals pay average weekly wages that are lower than nonproprietary hospitals whether the latter are private or governmental. Evidently, the greater the attenuation of profit incentives in the organization, the less emphasis given to obtaining personnel at wage rates comparable to the proprietary hospital.

In only one instance, to our knowledge, is there direct evidence that governmental hospitals are more cost-effective than private hospitals. Lindsay (1976) reported that the per diem costs of Veterans Administration hospitals were substantially lower than at proprietary hospitals. However, this finding does not contradict the assertion that profit-oriented enterprises are more efficient than nonprofit firms, because Lindsay showed that the quality of care was much lower in VA hospitals than at private facilities. In bureaucracies, managers devote resources to the measures of output that are monitored by the bureau sponsor. Because medical care is difficult to measure directly, costs or costs per patient day are often used as surrogates. It is obviously much less expensive to care for a patient who is not seriously ill than a very ill patient. In order to minimize costs per patient day, patients may be held in the governmental hospital much longer than in a proprietary hospital for the same medical procedure. As shown in Table 3, Lindsay presented evidence which indicates that the average length of stay is much longer at VA than at voluntary hospitals for the same surgical procedure. Therefore, because the quality of care is very different between VA hospitals and voluntary hospitals, the conclusion that bureaucratically produced health care is less costly is unjustified, for improvements in quality would raise unit costs.

SHIP REPAIR

Naval support ships are, in many ways, similar to merchant marine vessels; for example, fleet replenishment oilers which refuel naval ships at sea have characteristics much like merchant tankers. In fact, between 1971 and 1977, commercial tankers under contract conducted more than 90 underway refueling operations for the Military Sealift Command (U.S. General Accounting Office, 1978b: 8). There are, however, substantial

TABLE 3
Average Lengths of Stay (Days) in VA and Voluntary Hospitals by Surgical Procedure for Patients 50-64 Years of Age Except Where Noted

Procedure	VA	Voluntary	VA/Voluntary
Pilonidal Cyst (35-49)	15.7	5.8	2.71
Diabetes mellitus	19.0	9.0	2.11
Acute coronary occlusion	31.5	21.7	1.45
Hemorrhoidectomy	15.3	7.1	2.15
Tonsils and adenoids (35-49)	6.4	2.4	2.67
Duodenum ulcer	15.2	6.7	2.27
Appendicitis	12.1	6.9	1.75
Inguinal hernia	17.1	7.2	2.38
Gastroenteritis and colitis	11.1	7.7	1.44
Gallstones	26.5	11.9	2.23
Pyelitis, cystitis, nephritis	11.6	6.0	1.93
Kidney stones	18.6	8.2	2.27
Prostate	22.1	9.7	2.28

SOURCE: Lindsay (1976: 1073).

differences between commercial and naval ships in the amount of time spent at sea and in the cost of maintenance. Although naval support ships are on sea duty only about 20% of the time, comparable commercial vessels are under way between 40% and 70% of the time. Because the wear and tear on equipment is greatest when a ship is at sea, it would be expected that, for comparable equipment, commercial vessels would experience maintenance costs considerably greater than naval ships, on the average. Such is not the case. Overall, the GAO (1978b: i) found that the "Navy's maintenance costs per ship average about $2 million a year compared to about $400,000 a year for a commercial ship." Naval/commercial costs and cost ratios for similar items of equipment are shown in Table 4. The naval/commercial maintenance cost ratios for similar equipment items range from a low of 3.3:1 to a high of 51.8:1, which clearly indicates that commercial maintenance costs are much lower on comparable equipment than naval costs.

In addition, whereas the typical naval support ship spends 30 to 68 days in repair each year, the commercial counterpart is out of

TABLE 4

Comparison of Selected Maintenance and Repair Costs for Similar Equipment Items on Navy Oilers and Commercial Tankers

Equipment Item	Naval Oilers	Commercial Tankers	Cost Ratio
Boiler refractory	$40,270.50	$2,860.50	14.1:1
Pumps, main feed	32,035.00	618.00	51.8:1
Pumps, cargo	80,380.80	3,328.00	24.2:1
Pumps, fire and flush	25,921.60	1,221.00	21.2:1
Propeller shaft, bearings	36,829.60	2,745.00	13.4:1
Turbines, nonengine	20,823.00	6,394.00	3.3:1
Turbines, service generator	66,111.20	4,044.00	16.3:1
Valves, safety	3,620.00	288.00	12.6:1

SOURCE: U.S. General Accounting Office (1978b: 42).

service for only 11 to 31 days annually. This finding is particularly surprising, for a naval ship is of little, if any, strategic value while in port undergoing maintenance. One would expect that, as much as possible, naval repairs would be made during operations at sea. However, the reverse is true, in that commercial ships make as many repairs as possible while under way and naval ship repairs are typically made in port. This is especially unexpected in view of the fact that commercial vessels carry a crew that is only a fraction of the size of the crew on naval ships. Among the 86 ships in the sample of commercial ships, the *largest* number of staff was 46, whereas the *smallest* crew size among the 58 naval support ships was 92; overall, naval crew size (exclusive of troops) ranged as high as 1438, with an average of 555 (GAO, 1978b: 27, 53-54).

The General Accounting Office report concluded that the Navy could reduce maintenance costs dramatically without significantly affecting readiness of the fleet by adopting commercial maintenance practices. Some years ago, it might be noted, naval shipyards ceased construction of new naval ships, and all new construction was contracted out to private yards because construction costs were significantly lower at private facilities which were awarded competitively bid contracts.

UTILITIES

Considerable research has been conducted on various aspects of publicly versus privately owned electric utilities by Peltzman (1971), Pike (1967), Moore (1970), De Alessi (1977), and others. An excellent survey of much of this material has been provided by De Alessi (1974: 36), who concluded that

> the evidence suggests that municipal firms, relative to privately-owned regulated firms, in general will: charge lower prices; have greater capacity; spend more on plant construction; have higher operating costs; engage in less wealth-maximizing price discrimination, including fewer peak-related tariffs; relate price discrimination less closely to the demand and supply conditions applicable to each group of users; favor business relative to residential users; offer a smaller variety of output; change prices less frequently and in response to larger changes in economic determinants; adopt cost reducing innovations less readily; maintain managers in office longer; exhibit greater variation in rates of return.

Even though regulation of rates of return reduces the effectiveness of the profit incentives in the private sector, the studies summarized by De Alessi (1974) indicate that substantial differences still exist between the behavior of firms in the public and those in the private sectors.

AIRLINE SERVICE

In the United States, airline services are provided exclusively by the private sector so that no direct comparison can be made between the efficiency of private firms relative to public firms. Airline services in Australia are provided by the private carrier, Ansett Airline, and by Trans Australian Airlines (TAA), the public carrier. Both airlines are regulated by the government; as shown in the citation below, the regulatory process produces conditions which are ideal for public/private efficiency assessments.

> Airline fleets, while changing in composition over the years nevertheless show that in any given year the number and models of airplanes are virtually identical for each firm. The heavily traveled main routes are the same for each airline. Ansett and Trans Australian planes still arrive [at] and leave airports at approximately the same time. Each enterprise provides essentially the same foods and services. The wage structure does not vary between companies. Even the privilege of carrying mail, formerly the responsibility of only one airline, is shared equally. . . . their symbiotic relationship is so pervasive it even reaches into their separate restaurants in Tullamarine Airport with each having the same number of tables and chairs.
>
> The magnitude and qualitative nature of almost all of the important economic variables associated with the operation of the two airlines have either been held constant or allowed to change simultaneously for both enterprises by the government. Because of the remarkable similarity in the inputs of the firms, variations in performance may be attributed ultimately to differences in entrepreneurial organization [Davies, 1977: 224-225].

In Table 5, the three efficiency measures employed by Davies (1977) are reported for the period 1958-1959 to 1973-1974. As is evident, the private airline outperformed its public counterpart in every year regardless of the efficiency measure considered. The "bureaucratic rule of two" appears to apply only to the tons of freight and mail carried per employee, for the ratios of private to public output for both passengers per employee and revenue earned per employee are closer to one than to two. Given the rigorous regulation to which the private carrier was subjected by the government, it is not surprising that there is little difference between the two types of firms. Regulation was carried to extremes:

> For example, the government requires that when one airline purchases a new airplane the other must buy the very same make and model. Moreover, to prevent any competitive gains, the planes are introduced into service at the same time. When the two firms began DC-9 service the planes were not only introduced on the same day, but the same hour [Davies, 1977: 224-225, n. 10].

TABLE 5

Three Measures of Efficiency for Public and Private Airlines in Australia, 1958-1959 to 1973-1974

Year	Tons of Freight & Mail Carried per Employee			Passengers Carried per Employee			Revenue Earned per Employee		
	Ansett[a]	TAA[b]	Ratio	Ansett	TAA	Ratio	Ansett	TAA	Ratio
1958-59	10.69	4.42	2.42	282	217	1.30	$ 7,172	$ 6,104	1.17
1959-60	10.77	4.57	2.36	309	259	1.19	7,758	7,016	1.11
1960-61	10.96	4.52	2.42	337	228	1.48	8,679	7,052	1.23
1961-62	10.84	4.64	2.34	331	246	1.35	8,425	7,367	1.14
1962-63	11.09	4.69	2.36	316	255	1.24	8,510	7,726	1.10
1963-64	11.06	4.83	2.29	324	274	1.18	9,071	8,093	1.12
1964-65	12.14	5.02	2.42	352	287	1.23	9,705	8,553	1.13
1965-66	11.08	4.88	2.27	354	294	1.20	10,479	9,072	1.16
1966-67	10.34	5.11	2.02	348	316	1.10	10,829	9,954	1.09
1967-68	9.57	5.41	1.77	363	337	1.08	12,080	11,033	1.09
1968-69	9.54	5.34	1.79	392	356	1.10	13,185	11,734	1.12
1969-70	9.35	5.80	1.61	414	390	1.06	14,118	13,146	1.07
1970-71	8.75	5.70	1.54	417	399	1.05	15,558	14,522	1.10
1971-72	8.82	5.63	1.57	437	414	1.06	17,280	15,644	1.10
1972-73	9.07	5.62	1.61	468	449	1.04	17,829	16,541	1.08
1973-74	10.02	6.06	1.65	532	496	1.07	21,461	19,183	1.12
Average	10.25	5.14	2.03	373	326	1.17	12,009	10,740	1.12

SOURCE: Davies (1977: 226).

a. Private airline.

b. Public airline.

The above example is an indication of the extent of government regulation of Ansett. The fact that the private firm was able to outperform the public firm consistently over a period of 16 years in spite of such severe regulation is, of itself, impressive testimony to the powerful incentives which exist in the private relative to the public sector.

The case studies outlined above clearly show that, without exception and in a wide variety of circumstances, private firms are far more efficient producers than either government firms or nonproprietary enterprises. These findings support the conclusion drawn from the discussion of utility maximization earlier that managerial incentives for efficiency are reduced in firms that do not seek profits. The model also suggests that there should be a bias toward labor as an input in bureaucratic operations, because the manager in the bureaucratic firm increases utility by increasing the number of subordinates. A similar bias should not exist in the private sector since profit maximization, which increases the manager's utility in this case, requires the selection of the most efficient combination of inputs. Although the empirical evidence on labor intensity in private vis-à-vis public enterprise is not as extensive as for cost comparisons, some significant findings have been reported.

LABOR INTENSITY AND PRODUCTIVITY

Orzechowski (1977) provided two cases in which the labor intensity in government is far greater than in private enterprise. First, he referenced a study by Spann (1977) based on data for 56 Pennsylvania cities with populations between 24,000 and 400,000 which showed that public trash collection requires 97.3% more employees than does private collection, other factors held constant. Second, Orzechowski (1977: 257) performed an empirical investigation of the labor intensity of 62 public and private universities that indicated "the public colleges in a state would be expected to employ roughly 40% more labor than the private colleges for the same size capital stock." In addition, Clarkson (1972: 381ff) showed that nonproprietary hospitals are more labor-intensive than proprietary institutions because personnel/bed, personnel expenses/total expenses, and personnel expenses/bed are all lower in proprietary than in nonproprietary facilities.

At the federal level of government, Orzechowski (1977: 250) estimated the amount of capital per worker and reported that, in 1963, there were $50,232 of capital per federal employee; if the Department of Defense is excluded, however, capital per worker declines to $28,252. The private sector, according to Orzechowski, had a much lower level of capital per worker: $12,030 in manufacturing firms and $4380 in service industries. These data seem to indicate that the private sector is more rather than less labor-intensive than the government sector at the federal level. Some caveats must be considered, however, before such a conclusion may be drawn.

One important issue is the size of the federal government work force. The U.S. Civil Service Commission (1976: 8) reported that the full-time civilian employment of the federal government was 2.56 million as of March 31, 1976. This, apparently, is only the tip of the bureaucratic iceberg, for other labor inputs are also employed, such as consultants and contractors who often use government equipment and facilities. Estimates of these "indirect" labor inputs very widely, but all indicate that the use of nonfederal employees for government work is substantial. For example, Lambro (1979: 109) stated:

> A good estimate would be that from three to four million persons are paid by the federal government through consulting contracts, research grants and payments made for the wages of state and local government employees. Secretary Joseph Califano of HEW recently testified to the Senate Appropriations Committee that his Department pays the salaries of 980,217 persons who work for private think tanks, universities and state and local governments. This is in addition to the 144,256 "regular" HEW employees. The Department of Defense estimates that it pays the salaries of an additional 2,050,000 people through consulting contracts and the like. This figure does not include 2,049,000 military personnel who are also federal employees.

A study encompassing the major departments of the federal government in fiscal year 1978 was conducted by Blumenthal (1979: 730-733) in order to determine the total number of individuals working indirectly for the federal government. The estimate was that 11 million were indirectly employed.[4] If the labor input measure for the federal government included the indirect employment, capital per worker would be much lower.

A second issue relating to the relative labor intensity of the federal government and the private sector is that one must distinguish between the acquisition of capital and its use. In the private sector, capital is purchased to improve the productivity of labor in order to lower the cost of production. In the government sector, capital equipment may be purchased more as an ornament to enhance the prestige of the office which acquires the equipment than to increase efficiency. A case study is useful to illustrate this point. Between 1969 and 1977, the federal government expended in excess of $295.1 million on the rental and purchase of word processing equipment (U.S. General Accounting Office, 1979c: 34). If the same rate of increase in expenditures is maintained, annual expenditures will exceed $300 million by 1982. Basically, these machines are memory typewriters which facilitate making corrections and editing and are quite common in the private sector.

The introduction of this equipment to the federal work force would appear to offer enormous potential for cost savings and manpower reductions:

> The federal government . . . employs over 171,000 secretaries, stenographers and typists. The annual salary outlay for these employees is over $1.5 billion. This secretarial force represents close to 11.5 percent of the total civilian white collar work force. Even slight increases in secretarial productivity would significantly lower the cost of this segment of the work force, thus making it particularly open to the application of word processing systems [U.S. General Accounting Office, 1979c: 2].

The General Accounting Office undertook an audit of the use of this equipment in ten agencies and various field offices to determine their cost effectiveness, for there was no evidence of a decline in the level of secretarial or clerical staffing. GAO (1979c: 20-21) found that "most agencies could neither demonstrate that they have increased their productivity nor that their word processing systems are, in fact, cost effective." Two particularly interesting cases were mentioned. The Internal Revenue Service had installed, over a five-year period, a number of machines which cost $71,000 in annual rental; some were used as little as 1.5 hours per day. The U.S. Office of Education, apparently as a result of the GAO audit, planned to return 60 word processing systems because they were unnecessary. Other examples of the federal government's failure to make efficient use of capital equipment are available (see, for example, U.S. General Accounting Office, 1978a).

If, in fact, the federal government is highly capital-intensive and the capital is appropriately used to maximize efficiency and reduce costs, it is surprising that federal debt collection and ship repair is far more costly than in the private sector. There is no evidence that the productivity of the federal sector has increased as rapidly as that of the private sector. According to Orzechowski (1977: 250-251), "the federal government lags behind the manufacturing sector in registered productivity gain by a fairly significant amount even when it is realized that the productivity index for the federal government is probably a serious overestimate."

In sum, there is ample evidence that private firms which seek profits are more efficient producers of services than their governmental or nonproprietary counterparts. State and local governmental enterprises are more labor-intensive than similar private firms, and, although it appears that the federal government employs more capital per employee than the private sector, important questions remain about the appropriate measure of the federal labor input and even whether the capital is efficiently utilized. These findings provide empirical support consistent with the utility maximization for managers of bureaucratic enterprises and for managers of profit-seeking firms.

IV. CONCLUSIONS AND POLICY IMPLICATIONS

Economic theory suggests that private rather than public enterprise should be the more efficient producer of goods and services, since private firms may seek optimal scale of operation without the constraints imposed by political boundaries and since the market imposes a discipline on the manager in the private sector that is absent in the public sector. In contrast to the manager of the private firm whose utility is increased by profit maximization, the self-interest of the manager of a government bureau is enhanced by increasing the number of subordinates. These hypothesized differences between public and private enterprise were confirmed by a survey of case studies of private/public production of refuse collection, fire protection, debt collection, health care and hospital services, ship repair, electric power generation, and airline services. Without exception, the empirical findings indicate that the same level of output could be provided at substantially lower costs if output were produced by the private rather than the public sector. The cost reductions would vary from activity to activity and, although the "bureaucratic rule of two" might not apply in every case, there is persuasive evidence that significant cost reductions could be achieved. Therefore, by passing these cost savings to the taxpayer in the form of lower taxes, it is possible to reduce taxes significantly without sacrificing public services.

Because of the nonexclusivity characteristic of public services, it is often taken for granted that public services should appropriately be both publicly financed and publicly produced. However, it is not necessary for public services to be either publicly financed or publicly produced in every case, and there are important economic benefits to the taxpayer where public involvement is absent. For example, refuse collection and education can be produced very efficiently when individuals contract directly with competing private firms. There is no economic justification for public provision of these services, nor is there a need for a government bureaucracy to contract with a single private firm.

The argument that economies of scale exist in trash collection which has been used to justify government contract with a single private firm is, as discussed earlier, largely specious. In any event, if scale economies do exist, they will be realized over time and do not need to be imposed by government fiat. Economic efficiency should be greatest when the competitive forces of the market are given full play.

There are, however, circumstances which justify public involvement in the private sector, such as the regulation of natural monopolies. Even when private firms are regulated, which attenuates to some degree the profit incentive, the empirical evidence indicates that the regulated private entity is still considerably more efficient than its public-sector counterpart.

It is important to emphasize again that, in most of the case studies analyzed, no attempt was made to identify and correct for the opportunity costs of public rather than private production. Private firms pay taxes and licensing fees at the federal, state, and local levels of government from which the public enterprise is exempt. Thus, the transfer of production from the public to the private sector would generate additional governmental revenues which are currently forgone. In addition, pension plans for government employees are rarely fully vested and represent a substantial future tax liability. If these considerations had been taken into account in the cost comparison studies, the private sector would have appeared even more efficient than the public sector.

The potential for cost reductions and tax savings by having private firms produce public services is not limited to the activities reviewed in this article, but also apply to a wide range of functions now undertaken by governments at the local, state, and federal levels. Moreover, the economies achievable are real and not hypothetical, as shown by the empirical evidence herein. The private-sector production of public services offers an excellent opportunity for tax reductions without sacrifice of services; the best of all possible worlds, at least in this case, can be achieved.

NOTES

1. Some firms are, by government mandate, restricted geographically in their operations; for example, the banking industry in some states is limited to unit banks or limited branching. The effects of such restrictions, however, can be and have been mitigated by the formation of holding companies.

2. The economics of "voting with the feet" was first developed by Charles M. Tiebout (1956) and is known as the "Tiebout hypothesis."

3. A number of other investigators of bureaucratic behavior also assert that bureaucrats express a labor bias. For example, see Tullock (1965), Borcherding et al. (1977), Marris (1964), and Williamson (1964).

4. For a detailed discussion of employment in the federal government and its growth during the past two decades, see Bennett and Johnson (1980).

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Senator **Danforth**. Senator East is in the room at this time. Senator, we would be delighted to hear from you. Thank you for being with us.

TESTIMONY OF HON. JOHN P. EAST, U.S. SENATOR FROM THE STATE OF NORTH CAROLINA

Senator **East**. Mr. Chairman, I thank you for the opportunity in letting me impose upon your valuable time and the time of the subcommittee here. I always hesitate to say that I will be brief. Senators are always saying that. It doesn't always turn out that way, but I shall make that effort.

I wish to commend you and the subcommittee for holding these hearings on what I and some others, including Senator Hayakawa, think is a very important matter; and I know under your able and distinguished guidance there will be extensive, fair, and exhaustive hearings on this. I am sure that whatever emerges will be prudent and wise. I would simply wish to thank you for allowing me to be a part of the decisionmaking process here.

Let me just explain then why I think that contracting out is a good idea—an idea whose time has come, to use that trite phrase—and where I hope you might possibly go with the matter.

Let me quote very briefly here what I feel is the essence of this bill, Mr. Chairman. Essentially, this legislation provides that no Federal agency shall "start or conduct any commercial or industrial activity" to produce goods or services in-house when the same can be procured from "any responsive and responsible profitmaking business concern at fair and reasonable prices."

It further authorizes the director of OMB to prescribe such rules and regulations and to take such other actions as may be appropriate to implement this policy and to draw up a schedule for the elimination of Federal in-house commercial and industrial activities that are in violation of it.

It also makes this policy applicable to the States and their localities, providing that no State or political subdivision thereof shall use Federal financial assistance to produce goods or services inhouse that can be obtained from the private sector on the same terms specified for Federal procurement under this bill.

That is the essence of this bill, the highlights of it, Mr. Chairman. Why do I think we need it?

First, Mr. Chairman, interestingly, we have quite a long history of the executive branch's interest in and commitment to this concept. In 1955, the Bureau of the Budget, in its Bulletin No. 55-4, declared:

> It is the general policy of the administration that the Federal Government will not start or carry on any commercial activity to provide a service or product for its own use if such a product or service can be procured from private enterprise through ordinary business channels.

Second, as regards the legislative branch, the General Accounting Office, which is, of course, our own in-house accounting office, in June of last year said:

> Despite the executive branch's policy to rely on contractors to provide the goods and services it needs, OMB information shows that an estimated 400,000 Federal employees are currently operating over 11,000 commercial or industrial activities at an estimated cost approaching $19 billion annually. These employees, representing

almost one-fourth of the total executive branch civilian work force, are performing work that could generally be contracted without endangering an agency's control over the direction of its programs. Janitorial, guard, laundry, and keypunching services are examples of commercial and industrial activities that could be contracted because the work is not of a policy, decisionmaking, or managerial nature.

The GAO, I would like to note, Mr. Chairman, offered the same recommendations it made in 1978: that Congress, "through legislation or otherwise," endorse a national policy of reliance on private enterprise for the Government's needed goods and services to the maximum extent feasible, insofar as doing so is consistent with the national interest, within the framework of procurement at reasonable prices and require executive agencies to report on their progress in supporting that national policy.

Both those quotes are taken from a publication of the General Accounting Office, "Civil Servants and Contract Employees: Who Should Do What for the Federal Government?," which is a report to the Congress by the Comptroller General of the United States, Washington, D.C., June 19, 1981, page 15.

What we witness here is, again, a very strong commitment going back nearly three decades. The Bureau of the Budget and OMB through its Circular A-76 have all indicated from the standpoint of the executive branch, the administrative branch of our three branches, that there is great merit to this idea.

What we do not have—and this is where I think we come in—we do not have at this point any legislative mandate for it, any legislative commitment for it. And in my judgment, Mr. Chairman, we ought to look at it and decide if it has merit. If it does, if our conclusions are the same as the executive branch, then I think we ought to put our imprimatur on it and move ahead. After all, policymaking is our primary responsibility under the separation of powers. We ought not let it go by default in the executive branch because it is unclear whether we are genuinely committed to the same concept that they say they are. Obviously, they feel there is merit in the idea.

I feel, Mr. Chairman, there is a legitimate and proper legislative goal to be achieved here. First, I think it would contribute—and the evidence is rather compelling—to significant budget savings. In this period of great deficits—and apparently we are a long way from getting out of this period—that in itself ought to commend it.

Second, the evidence is compelling that it would help small businesses, and in particular small service businesses, which are the backbone of our economy. They are the most labor-intensive sector of the U.S. economy, and I might note here that minority businesses, which often have great difficulty in getting established and continuing, would have the most to gain from passage of this legislation.

As government at all levels—Federal, State, and local—has consumed more and more of the gross national product, has been providing more and more goods and services on its own, it has tended to crowd out this very vital sector of our economy. I would feel it appropriate that we might try to give them some legislative relief, at least indicating our concern about the survival of small businesses.

What kinds of firms would one reasonably anticipate might be affected? Well, I know that the chairman is familiar with this, but I will briefly cite printing, for example, janitorial and food services, laundry and drycleaning, travel agents, audiovisual productions, trash collection, security guards, pest control, et cetera.

You were commenting earlier before I came in on what savings one might anticipate. As was indicated, it is estimated by OMB that it could be as much as $3.6 billion between 1982 and 1987. Again, that's an OMB figure. I would submit it's a minimum figure. I would argue that if the concept of contracting out is sound, it would be difficult to exaggerate the savings that could be achieved. There seems to be a general consensus that significant savings would result from a consistent policy in this area. And then on top of it, I underscore heavily, it would contribute to the revitalization of the private sector. It would be a boon to small business. It would broaden and deepen the tax base.

Mr. Chairman, I acknowledge that there are certain caveats involved in moving in this direction. I know in your great prudence, you would, of course, be sensitive to them, too, and I acknowledge that. We are not suggesting here—and I don't think the proponents are—that we can settle for a diminution in quality of goods or services if we move in this direction.

This bill is not designed to be a subsidy for small business. It is designed to let them be a part of a competitive process in which Government tries to get the best quality of goods and services at a competitive price. That certainly is the spirit in which I support it, and I know those organizations supporting it also share that commitment.

We obviously would want to have legislation that would make sure that we don't have—as that ugly phrase has it—"bid-rigging." Rather, we want a genuinely competitive situation, not a cozy relationship between a Government agency and some preferred small business out in the private sector.

I also appreciate, Mr. Chairman, as an additional caveat, that there are very sensitive areas of Government employment. National defense obviously comes to mind, where we would have to insure that certain operations be kept in-house.

I would conclude, Mr. Chairman, by suggesting that that is our responsibility—to decide if contracting out is or is not good policy. If it is, we ought to frame the legislation and the procedures for implementing it. Again, I would submit, Mr. Chairman, that the resulting benefits would be twofold: (1) budget savings and (2) helping to revitalize the private sector. In the case of the latter, the emphasis, as I have already said, is on the small firms which are the backbone of the American economy, the most labor-intensive sector of our economy, and probably the one that has fallen the greatest victim of what I call crowding out in terms of all governments in our Federal system taking a greater and greater share of the gross national product.

I think it is a good idea, Mr. Chairman, and I am honored that Senator Hayakawa has joined with me in this concern. I would like to note the distinguished senator from Texas, Senator Bentsen, has previously shown an interest in it. I think there are many senators who would be interested in the idea. They will, of course, want to examine it and make their own independent judgments on it; but I repeat my opinion: The idea has sufficient merit that it ought to be examined, and we ought to make a decision.

Thank you, Mr. Chairman, for the opportunity to be with you.

Senator **DANFORTH**. Thank you very much. Without objection, your full statement will be included in the record.

To state a policy is one thing; to find something happening after the policy is stated is quite another.

Supposing we were to state a policy and find out that after doing so—after passing a bill or a resolution or whatever—it turns out that there is no change. Government continues to proceed on the same old course. Then what happens?

Senator **EAST**. Well, that is not an uncommon problem here in the Nation's capital, and in our dealing with the matters. The problem, I think, of implementing any legislative policy is always a difficult one. Taking one from an unrelated field, social security—we are all the time trying to grapple with problems. Legislation has to be revised; priorities have to be reordered, and modifications made in the substance or the procedure of legislation.

I would simply argue, Mr. Chairman, that is not unique to this particular problem. That is inherent in the nature of representative government and inherent in the nature of policymaking by a representative democratic chamber.

But I do not see anything sufficiently unique or extraordinary about this problem that one would have to conclude at the outset that it is beyond our abilities to explore and to implement and to make operational in some reasonable way if we decide it is a good idea and if we decide that there are practical mechanisms for implementing it. I don't see anything unique about it.

Senator **DANFORTH**. Do you have any thoughts as to how such a policy would be implemented? Would it just be a matter of the regular authorization and appropriation process, and oversight?

Senator **EAST**. Well, as the legislation—let me back up for a moment. In the past, what we have really had is simply an expression of the opinion by the executive branch that it would be a good idea. But rather consistently, I might note, in recent years and decades, we have not had what I would call the force of law behind it in terms of the legislative mandates, or it has been pretty well neglected or ignored or overlooked, if that is a more neutral term.

As you will note in the legislation, we do state what the policy is. We like to feel that the language we have used is a balanced and prudent statement of it. We do then give to OMB—the director of OMB, obviously—a primary responsibility to implement this. We may turn out in time to want to make a corrective force there, but we have our own, if you will, in-house entities—GAO or OMB—that I feel we can rely on to develop, through our legislative guidance, procedures of implementation, and that will take great expertise to do that. We will want to do it with care and prudence.

But I don't, again, see anything so unusual about it, so extraordinarily difficult, that we wouldn't even want to take the plunge.

Ultimately, on your good point about whether anything would really change, what we are trying to do is (1) to state a policy: "We ought to rely more on the private sector"; (2) having said, "That's the way we want to go," where appropriate and proper and so forth, the way that the private sector would become involved is through competitive bidding. No question about that.

Then it becomes a matter of the procedures that we might decide, in conjunction with our resources—OMB, GAO, et cetera, would be appropriate procedures for implementing it.

Senator DANFORTH. Senator East, thank you very much.

Senator EAST. Thank you, Mr. Chairman. I appreciate the opportunity.

[Senator East's prepared statement follows:]

STATEMENT OF

SENATOR JOHN P. EAST

Mr. Chairman and members of the Subcommittee:

I appreciate the opportunity to be with you this morning; I am proud to join you in your efforts to reform federal procurement practices. Reform is essential if we are to eliminate unproductive government competition with the private sector and to ensure that the American people receive the highest possible value for their tax dollars.

The federal government currently produces a vast array of goods and services in house that it could obtain more easily and cheaply from private sources. In consequence, it not only wastes enormous sums of money each year, it undercuts its own tax base as well.

All this is needlessly self-defeating. In America, perhaps more than in any other nation, the superiority of private over public enterprise is generally acknowledged. The private sector is more innovative, efficient, productive, responsive, and cost-effective than the public. It is all these things because it is subject to the incentives and discipline of the market economy, while government monopolies are immune to them. Therefore, where a viable market alternative exists, it is almost invariably in the public interest for government to take advantage of it.

This has been the official position of the executive branch since 1955. In January of that year, Bureau of the Budget Bulletin No. 55-4 declared as follows:[1]

> It is the general policy of the Administration that the Federal Government will not start or carry on any commercial activity to provide a service or product for its own use if such a product or service can be procured from private enterprise through ordinary business channels.

This policy, reaffirmed by OMB Circular A-76 in 1966, remains in effect today, subject to certain qualifications added in 1979. It is, however, frequently unenforced.

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[1] as quoted in U.S., Small Business Administration, Government Competition: A Threat to Small Business, Report of the SBA Advocacy Task Group on Government Competition with Small Business. (Washington, D.C.: March, 1980) p. 60.

In a report to Congress issued on June 19 of last year, the General Accounting Office cataloged the extent of this neglect:[2]

> Despite the executive branch's policy to rely on contractors to provide the goods and services it needs, OMB information shows that an estimated 400,000 Federal employees are currently operating over 11,000 commercial or industrial activities at an estimated cost approaching $19 billion annually. These employees, representing almost one-fourth of the total executive branch civilian workforce, are performing work that could generally be contracted without endangering an agency's control over the direction of its programs. Janitorial, guard, laundry, and keypunching services are examples of commercial and industrial activities that could be contracted because the work is not of a policy, decisionmaking, or managerial nature.

To remedy the situation, the GAO offered the same recommendations it made in 1978 -- i.e., that Congress, "through legislation or otherwise:"[3]

> -- Endorse a national policy of reliance on private enterprise for the Government's needed goods and services to the maximum extent feasible, insofar as doing so is consistent with the national interest, within the framework of procurement at reasonable prices and
>
> -- Require executive agencies to report on their progress in supporting that national policy.

Senator Hayakawa, Senator Bentsen, and myself have responded to this request for remedial legislation. My own bill, S.2278, is in the same spirit as those introduced by my distinguished colleagues. Like theirs, it clearly states that the policy of the federal government is to rely on competitive private enterprise to meet its needs. But in its particulars it is more specific and far-reaching than any comparable measure presently before Congress.

It provides that no federal agency may "start or conduct any commercial or industrial activity" to produce needed goods or services in house, when the same can be obtained from "any responsive and responsible profitmaking business concern at fair and reasonable prices." It further authorizes the Director of the Office of Management and Budget to "prescribe such rules and regulations and to take such other actions as may be appropriate to implement /this/ policy," and to draw up a schedule for the elimination of federal inhouse commercial and industrial activities that are in violation of it. The bill also makes this policy applicable to the states and their localities by providing that no "State or political subdivision thereof" shall use federal financial assistance to produce goods or services in house that can be obtained from the private sector on the same terms as specified for federal procurement.

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[2] U.S., Congress, General Accounting Office, Civil Servants and Contract Employees: Who Should Do What for the Federal Government?, Report to the Congress by the Comptroller General of the United States (Washington, D.C.: June 19, 1981), p. 15.

[3] Ibid.

While this last provision may prove somewhat controversial, I feel it is necessary. Uneconomical public enterprises and unfair competition with the private sector exist at every level of government, not just the highest. Billions of dollars in federal grants actually compound the problem. Congress owes it to the taxpayers to ensure that these grant monies are spent wisely. Besides, there is a genuine need for greater reliance on the private sector throughout our federal system. Many communities have already experimented with private refuse collection, ambulance, and even fire protection services, and have found that they can cut costs without compromising quality. A consistent national policy on contracting out would encourage this trend.

Such a policy would also do millions of small businesses more good than a raft of special assistance programs, since small firms are the backbone of the service industries. Furthermore, since small businesses create most of the new jobs in this country, government workers who were displaced by the contracting-out process would be able to find new jobs in the revitalized private sector.

Before concluding, I would like to lay particular emphasis on the savings that could be achieved in the area of national defense. At this time, we in Congress are all attempting to give taxpayers "more bang for the buck." I suggest that contracting out noncombat support systems is a particularly effective way of trimming the defense budget.

Mr. Chairman, I am convinced that this proposal could streamline government at all levels and save us billions of dollars. Just how many billions is at this point a matter of conjecture. The Office of Management and Budget has estimated that $3.6 billion could be saved over fiscal years 1982-87 if the federal government were to contract out more to the private sector.[4/] This figure is admittedly a rough guess based on incomplete data.[5/] It does not include commercial and industrial activities with annual operating costs of less than $100,000; it does not reflect the tax revenues that government would gain when it stops competing with the private sector; it does not take account of the funds that could be raised through liquidation of assets when in-house operations are discounted; and, lastly, it does not calculate the savings that could be realized by applying the contracting-out principle to the states and localities through federal grants.

In short, while I cannot tell you exactly how much money could be saved if S.2278 were to become law, I think I can safely say that OMB's estimate must be regarded as a bare minimum. Mr. Chairman, I recommend that contracting out be made the watchword of government procurement at all levels of our federal system. I thank you for giving me the time to address this issue today.

[4/] Ibid., p. 16.

[5/] U.S., Congress, Senate, Committee on Small Business, Government Competition With Small Business: Hearings Before the Subcommittee on Advocacy and the Future of Small Business, 97th Congress., 1st sess., 24 June 1981, p. 259.

Senator DANFORTH. All right, the next witnesses are John Eisenhour, Jr., and David McCosker.

Mr. Eisenhour, would you like to go first?

TESTIMONY OF JOHN E. EISENHOUR, JR., CHAIRMAN, NATIONAL CONSTRUCTION INDUSTRY COUNCIL

Mr. EISENHOUR. Mr. Chairman, I am John Eisenhour, Jr., president of Eisenhour Construction Co. of Denver, Colo., with offices in East Lansing, Mich., Charlotte, N.C., and Dallas, Tex. I appear today in my capacity as the chairman of the National Construction Industry Council, an organization composed of 28 trade associations representing all facets of the construction industry. Included in the National Construction Industry Council's membership are design professionals, material suppliers, equipment manufacturers and distributors, general and subcontractors. Taken together, the members of NCIC represent over 100,000 construction and construction-related firms and more than 150,000 design professionals.

I am very pleased to be here to present the view of the construction industry supporting S. 2278 and Senate Joint Resolution 93. I wish to personally thank Senators Hayakawa and East for sponsoring the legislation. I thank Senator Danforth and the subcommittee for holding this hearing.

Senate Joint Resolution 93 established a basis for the legislative remedy for the contracting-out problem. This problem which has plagued the construction industry and related industries for years requires such a legislative remedy.

Some have suggested that OMB Circular A-76 goes far enough, that it provides policy guidance to Federal departments and agencies to contract out. However, it has been applied inconsistently by past administrations and, although it does set Government policy, is not a very sufficient force to insure an end to the problem of the growth of in-house commercial and industrial activities of the Government.

In any event, Circular A-76 has proved insufficient to deal with this problem for the following reasons: The cost comparison standards cannot be made to equate the operations of a not-for-profit Government entity with a "going concern" in the private sector. Even if there were an adequate basis for public versus private sector cost comparison, the Government itself is charged with the responsibility for completing the cost comparisons. The Government enjoys a significant handicap; that is, unless there is at least a 10-percent cost differential, the activity under comparison can be completed by the Government. There are a number of exceptions to A-76 which Federal agencies can and do use to protect certain activities from contracting out. The provisions of A-76 are not applicable in a Federal aid program context. Revisions of S. 2278, as written, provide remedies to these problems.

However, we also support extension of these provisions to Federal aid programs. In light of this administration's commitment to New Federalism and the reshaping of relationships between Federal, State, and local governments, we believe that extending the contracting-out requirement to Federal aid programs would be consistent with its stated objectives.

It does no good to reduce the size and scope of the public sector at the Federal level only to encourage significant growth in State and local governments. Also, in light of the current climate of deregulation, it would be consistent for this administration to help relieve the private sector from governmental interference which is inefficient, unproductive, and unnecessary; encouraging local governments to contract out work under Federal aid programs would do this.

In addition to the advantages to the industry itself, we strongly believe it would be in the best interest of the taxpaying public for the Government to rely on contracting out for a greater amount of needed goods and services.

Cost comparisons conducted by governmental entities fail to take into account many factors. Different accounting procedures are used by public agencies and private concerns, making it difficult to determine the true cost of a project and whether the agency's or the private contractor's cost is less.

Also, the taxpaying public is better protected by using private concerns than it is where governmental entities perform the work. For example, where private contractors are used: The public pays only for what it receives; work actually performed is the basis of payment. The price is generally fixed, and the public has no risk of cost increases; these are borne by the contractor. Timely completion is assured by liquidated damage provisions. Faithful performance is backed by a 100-percent performance bond. Part of the contractor's earnings are retained until acceptance, as added insurance of satisfactory performance. The risk of damage during construction is borne by the contractor, not the public. The contractor must defend and hold harmless the public against claims and must provide the public with insurance coverage. Quality inspection is at arm's length by independent inspectors. Finally, the work is warranted and defects must be corrected at no expense to the public.

In addition, there is the problem of duplication of equipment. There are no complete statistics, but it is obvious that millions of dollars' worth of equipment is owned by governmental entities. If there were more work to be performed than privately owned equipment was capable of doing, there might be justification for public investment in construction equipment. However, this is simply not the case. Publicly owned equipment is rarely utilized to capacity. Downtime is rarely calculated into agency cost estimates. However, this equipment is readily available on a rental basis in the private sector to be used and paid for only as needed with the attendant reduction in overhead and maintenance costs.

Also, the question of tax revenues: Work performed by the private sector results in significant tax income: license fees; stamp taxes; Federal, State, and local income taxes. As a final note, the vast majority of businesses affected in this matter are small businesses.

To conclude, Mr. Chairman, S. 2278 will get the Government out of the business of doing business while preserving the Government's role in performing policymaking. Legislation complements the administration's aim to get the Government off the backs and out of the pockets of all Americans.

Mr. Chairman, thank you again for the opportunity to testify. I'd be pleased to respond to any questions.

Senator Danforth. Thank you, Mr. Eisenhour. Without objection, your full statement will be included in the record.

[Mr. Eisenhour's prepared statement follows:]

Statement Of John E. Eisenhour, Jr.

Mr. Chairman and Members of the Subcommittee. I am John Eisenhour, Jr., President of Eisenhour Construction Company, of Denver, Colorado, with offices in East Lansing, Michigan; Charlotte, North Carolina; and Dallas, Texas. I am appearing today in my capacity as Chairman of the National Construction Industry Council, an organization which is composed of 28 trade associations representing all facets of the construction industry. Included in NCIC's membership are design professionals, material suppliers, equipment manufacturers and distributors, general and subcontractors. Taken together, the members of NCIC represent over 100,000 construction and construction-related firms and more than 150,000 design professionals.

I am very pleased to convey strong support of the construction industry for both Senate Joint Resolution 93 and S. 2278. Both of these legislative vehicles address a longstanding concern in the construction industry, that of being forced to compete for scarce work against taxpayer-financed governmental entities. This unfair competition occurs at every level of government, federal, state and local. Many design professionals, for example, have had continuing concern with competition from in-house staffs of federal departments and agencies. Others, particularly in the highway industry, are right now experiencing serious competition from state and local government transportation agencies. For that reason, we are particularly supportive of the language in S. 2278 which includes federal-aid expenditures within the scope of the legislation.

Mr. Chairman, in the course of the hearings before the Senate Small Business Committee last fall on Senate Joint Resolution 93, a number of groups testified in support of a legislative remedy to the "contracting out" problem. We at NCIC applaud Senator Hayakawa for his resolution, which represents a significant first step.

In our view, S. 2278 builds on that first step through codification of OMB Circular A-76, which to this date is the basis for Executive Branch policy to rely on the private sector.

Some have suggested that OMB Circular A-76 "goes far enough" -- that it provides sufficient policy guidance and direction to federal departments and agencies to "contract out". Unfortunately, the record shows that this is simply not the case.

The government's "contracting out" policy was first expressed in temporary bulletins issued as early as 1955 and made more permanent with the issuance of OMB Circular A-76 in 1966. In the latest revision to Circular A-76, dated March, 1979, federal agencies were given three years to inventory their respective commercial and industrial activities, make in-house versus contracting-out determinations and establish schedules for periodic review of those determinations. The

Department of Defense has completed more of these determinations than other agencies and in 60 percent of those comparisons conversion of in-house activities to contract proved to be more economical.

Perhaps that is why Congress today is being asked by various special interests to adopt a one-year "contracting out" moratorium and a number of measures exempting certain activities from the provisions of A-76 are being introduced in the House and Senate.

In any event, Circular A-76 has proved insufficient to deal with this growing problem for the following reasons:

- The cost comparison standards cannot be made to equate the operations of a not-for-profit government entity with a "going concern" in the private sector.
- Even if there was an adequate basis for public versus private sector cost comparison, the government itself is charged with the responsibility for completing the cost comparisons.
- The government enjoys a significant "handicap". That is, unless there is at least a ten percent cost differential, the activity under comparison can be completed by the government.
- There are a number of exceptions to A-76 which federal agencies can and do use to "protect" certain activities from contracting out.
- The provisions of A-76 are not applicable in a federal-aid program context.

On this latter point, during last year's hearings on Senate Joint Resolution 93, testimony was submitted which indicated that hundreds of millions of dollars of federal-aid money was spent on "force account" work in the highway area alone. These funds could have been more effectively and efficiently spent in the private sector. In my home state of Michigan, there are at least ten government-owned asphalt plants which are used to compete against private firms and which have secured for themselves lucrative paving contracts for city, county and state work. This is but one example. Federal-aid monies in all states are used to purchase plants and equipment and to build up labor forces, none of which can be effectively used to get the most for the taxpayer's dollar.

Mr. Chairman, we appreciate the problems inherent in dictating to state and local governments the procedures by which federal-aid funds are to be expended.

However, in light of this Administration's commitment to New Federalism and reshaping the relationships between federal, state and local government, we believe some guidance is not only necessary, but can be constructive and useful. As a practical matter, it does no good to reduce the size and scope of the public sector at the federal level only to encourage significant growth in state and local government.

A similar criticism which has arisen with respect to extending coverage of this legislation to federal-aid work is that, given the current climate of deregulation, it would be inappropriate for the Congress to impose new regulatory restrictions and burdens on state and local governments in connection with the expenditure of federal funds.

We believe this criticism is invalid and that the extension to federal-aid programs is consistent with the thrust of this Administration in seeking deregulation as a means of relieving the private sector from governmental interference which is inefficient, unproductive and unnecessary. We also believe that "contracting out" can be an important source of "political capital" to state and local officials attempting to cope with the challenge of growing public needs and declining fiscal capacity.

No one would disagree with the proposition that governmental entities must take care to insure that the public's interest is best served when the expenditure of tax dollars is involved. Unfortunately, few governmentally-conducted cost comparisons accurately consider costs to the taxpayer. If both public agencies and private concerns used the same cost accounting procedures, it would be relatively easy to determine the true cost of a project and to determine whether the agency's cost or the private contractor's cost was less. However, there is no uniformity in the accounting systems used by public agencies and private concerns and we believe achieving uniformity is all but impossible.

First, it should be recognized that wages paid by public agencies for construction labor are substantially lower than

than the rates which federal and state laws require private contractors to pay for the same services. The effect of this is to create an inherent disadvantage to the private sector in any comparison of public and private construction costs. In this regard, I might add that if it is deemed sound social policy to mandate by law a certain wage level on public works projects with private concerns, as under the provisions of Davis-Bacon and the Service Contract Act, it is difficult to understand why that policy should be diluted by exempting public agencies from paying the stipulated wages.

The second difference with respect to wages is that, in the private sector, workers go directly to the project site while public employees generally move to and from the project site daily. Thus, while both crews may be paid for eight hours of work a day, public employees are rarely on the jobsite for that length of time.

The third area of distortion with respect to costs concerned with wages occurs with respect to fringe benefits. For example, retirement benefits may be a separate agency budget and, thus, costs associated with these benefits are not allocated to the project costs as they are in the private sector. Furthermore, the cost of worker's compensation is usually not included in cost estimates for agency construction.

Both material and equipment costs are usually inaccurate where the public sector accounting is used. Most public agencies do not accurately record the support costs related to ownership and operation of equipment used to produce material such as crushed rock or asphalt. The majority of public agencies do not have effective cost accounting systems which take into consideration the true cost of owning and operation equipment.

If legislative policy is that public improvements are to be built at the least cost, then it is imperative that public agency accounting systems realistically reflect the costs that are incurred by the agency.

The taxpaying public is generally better protected by using private concerns than it is where governmental entities perform the work. For example, where private contractors are used:

- The public pays only for what it receives; work actually performed is the basis of payment.
- The price is generally fixed and the public has no risk of cost increases; these are borne by the contractor.
- Timely completion is assured by liquidated damage provisions.
- Faithful performance is backed by a 100 percent performance bond.
- Part of the contractor's earnings are retained until acceptance, as added insurance of performance.
- The risk of damage during construction is borne by the contractor, not the public.
- The contractor must "defend and hold harmless" the public against claims and must provide the public with insurance coverage.

- Quality inspection is "at arm's length" by independent inspectors; and
- The final work is warranted and defects must be corrected at no expense to the public.

There are similar advantages in other elements of our industry and in other industries. None of these protections of the public's interest exist when work is performed by a public agency with public equipment and personnel. Whenever any cost comparison is mandated by law, substantial allowance should be made for the benefit of protection which the public receives when a private contractor agrees to do the job.

Finally, there is the problem of duplication of equipment ownership and the loss of taxes. While there are no complete statistics, it is obvious that millions of dollars worth of equipment is owned by governmental entities. If there was more work to be performed than privately-owned equipment was capable of performing, some justification might exist were the public investing in construction equipment. However, this is not the case. Publicly-owned equipment is rarely utilized to capacity and down-time is rarely calculated into agency cost estimates. Yet all of this equipment is available and can be rented from the private sector on an hourly basis, to be used and paid for only when it is needed. Furthermore, publicly-owned equipment pays back nothing in the way of fuel taxes, license fees and income taxes. The increased use of privately-owned equipment could, conceivably, lead to even lower equipment rental rates than are now possible.

Private studies have indicated that a contractor will return to the public "off the top" of its bid, almost eight percent in taxes. Some of the taxes paid by private contractors include federal income tax, state excise tax, county business income taxes, city licenses, property taxes, payroll taxes, federal excise tax on equipment, federal excise tax on fuel, tires, telephones, federal use taxes, federal stamp taxes on performance bond, federal stamp taxes on bond reinsurance, federal self-employment taxes on contractor-proprietors, state homebuilders licenses, state corporation fees, state use taxes on trucks. By comparison, public agencies at the state level generally pay taxes only in the payroll area. No property tax is paid, no equipment tax is paid, no federal fuel tax is paid, no federal use tax is paid, no state excise tax on income or federal income tax or stamp tax on bonds or local income taxes are paid. It is obvious that the recycling of tax dollars paid by private contractors can have a beneficial effect on both the economy and the public. It should also be noted that the vast majority of businesses affected are small businesses.

In summary, Mr. Chairman, we believe the provisions of S. 2278 constitute an effective remedy to a longstanding problem -- getting the government, at all levels, out of the business of doing business. We believe this measure is consistent with the Administration's goal to reduce the size and scope of government activity. And we think that "contracting out" can play a key role in making New Federalism work effectively.

Thank you again for this opportunity to testify. I would be pleased to respond to any questions you may have.

Senator **Danforth**. Mr. McCosker is our next witness.

TESTIMONY OF DAVID A. McCOSKER, CHAIRMAN, CONTRACT CONSTRUCTION COMMITTEE, ASSOCIATED GENERAL CONTRACTORS OF AMERICA, AND PRESIDENT, INDEPENDENT CONSTRUCTION COMPANY, OAKLAND, CALIF., ACCOMPANIED BY DAVID JOHNSTON, DIRECTOR, HEAVY-INDUSTRIAL DIVISION, ASSOCIATED GENERAL CONTRACTORS OF AMERICA

Mr. **McCosker**. Good morning, Senator Danforth. I am Dave McCosker. I am the president of Independent Construction Co. in Oakland, Calif. Today I am testifying for the Associated General Contractors of America as chairman of their Contract Construction Committee. Seated with me is David Johnston from our AGC staff.

You have our entire testimony. It has been submitted to you. I am going to go through this briefly. I would like to cite some examples that we feel would point out to you the magnitude of what this piece of legislation might be able to accomplish.

AGC supports Senate Joint Resolution 93 and S. 2278, which reaffirm the basic policy of Government—that it should not compete with the competitive free enterprise system; it should rely on that system for the goods and services it requires. The expression of support for reliance on the competitive free enterprise system by both Houses of Congress should substantially bolster OMB's effort to implement its standing policy, as expressed in OMB Circular A-76, of reliance by direct Federal awarding agencies on the private sector.

S. 2278 will be a major step in this effort. It will require agencies to review their policies on in-house production following its enactment, and presumably such an evaluation to comply with S. 2278 will be undertaken following the provisions of A–76.

The passage of Senate Joint Resolution 93 and S. 2278 is greatly needed. Despite the existence of Office of Management and Budget Circular A–76, which requires cost comparisons prior to the Federal Government considering initiating a commercial activity for the procurement of needed goods and services, Federal construction agencies ignore strict utilization of this circular. Those agencies which provide Federal assistance funds are not explicitly required to follow A–76.

One of the more blatant examples of indifference to A–76 is the Tennessee Valley Authority, which did approximately $2 billion worth of force account work in fiscal year 1981. After receiving Circular A–76 in 1967, the Tennessee Valley Authority defined its entire construction program as an "existing government activity" and waived the requirement for further review. As a result, TVA has exempted itself from the requirement to cost-justify its force account construction.

We believe that, in the public interest as well as in the interest of fostering the Government's policy of utilization of private enterprise, TVA should meet the requirements of OMB Circular A-76. The taxpaying public has a right to have its funds spent in the most efficient and economical manner possible on all public works projects. The distinction between Federal and federally assisted construction programs should not be a reason to deny the security of comprehensive cost comparisons in protecting public expenditures from inefficient use.

In addition to providing the most efficient and economical means of producing public works construction, contracting out provides a variety of other benefits to the public in the form of risk shifting which cannot be obtained under in-house performance. These benefits, sir, are listed in my testimony and are there for your review.

Another benefit of the contract method often overlooked by public officials is the return of part of the contract price to the public treasury in the form of taxes. An Oregon study concluded that taxpayers receive a net return of more than 20 percent of the contract cost when contract construction is chosen over force account construction. This indirect cost reduction to the public is not factored into cost comparison computations and results from a variety of use, excise, employment, and income taxes.

Although cost is the most important factor in deciding whether to contract out or use in-house forces, public agencies should also be aware of the social implications of doing their own construction. We are in an industry made up of hundreds of thousands of small firms. Performance of small- and medium-sized projects by public agencies forecloses important growth opportunities for emerging small firms, including many minority-owned firms, as has been mentioned. Because of low overhead costs, these small firms are very cost competitive. Construction by force account of these small- and medium-sized projects denies small firms their rightful place in the market.

In order to reinforce the Federal Government's policy of depending on the private sector for needed goods and services, not only for direct Federal procurements but federally assisted as well, we believe there are a number of options that exist. The first would be the revision of OMB Circular A-76 to include those federally assisted activities, including Federal loans and loan guarantees. This extension, we believe, should also include activities of the Federal Financing Bank. Expansion of OMB Circular A-76 to include federally assisted construction would also provide many State and local governments their first experience in using comprehensive cost comparisons. Currently, there are no standard cost comparison principles in public sector accounting. With reduced budget outlays, public officials now have an increased responsibility to assure that the remaining funds are spent in the most efficient and economical manner. Skills developed in administering cost comparisons in federally assisted programs would assist States in the transfer of those principles to strictly local projects, thus achieving efficiencies similar to those available in direct Federal procurement. So that the policy in A-76 is clear to recipients of Federal grants and funds, we believe that the requirement for adherence to A–76 should be included in OMB Circular A–102.

The example, sir, that I wanted to show you was the magnitude of what could come from this. The county of Los Angeles, back in 1978, passed Proposition A. From that proposition, they contracted out. They reviewed what could be contracted out, and they did contract out 141 different contracts as of March 9, 1982. The cumulative contract cost was some $19,648,000. The cumulative cost savings, or avoidance as they call it, amounted to $10 million. So you are looking at $10 million in addition, or a total of $30 million, to what it originally cost them when they did it in-house.

I thank you very much for your time, Senator.

Senator **Danforth**. Thank you very much, Mr. McCosker. Without objection, your full statement will be included in the record.

Let me just say I am a little bit at a loss to know how we would be better off with legislation than we are with the present requirement. It's been a matter of Federal policy since the 1950's, and OMB Circular A–76 has been on the books for some time.

Mr. **McCosker**. Well, sir, one of the biggest problems that we have had, especially out in California, but also throughout the country, has been in dealing with an agency and trying to get them to legitimately show us their actual costs on doing a project. The city of Concord was one where we had an action against them, and we were successful in it. But their costs, where we have a government code, allow them to go up to $5,000 in force account where they were exceeding it. But they were doing it by taking CETA funds at that time, which amounted to, I believe, $5 or——

Senator **Danforth**. Here is the question: Why will we be better off if we pass a statute than we are with OMB Circular A–76? Is it just a matter of stating the Federal policy in legislation? Frankly, I don't understand why we have to pass a law.

Mr. **McCosker**. For federally assisted programs, you do not have it. You will establish——

Senator **Danforth**. Let me say on federally assisted programs, that is different. Frankly, my guess is that as we move from categorical grants to block grants we are also trying to move away from all kinds of specific restrictions on local governments, on grant recipients. My guess is that—and maybe I'm wrong—we are probably not going to attempt through legislation to place additional requirements or restrictions on grant recipients.

So just dealing with Federal procurement in and of itself, I am not sure why we would be any better off having passed contracting-out legislation. I am all for the contracting-out concept. The question is, how do we make it work?

Mr. **McCosker**. The piece of legislation, sir, would require some cost accounting policy, some form to follow, so that they actually know whether they in fact can do it less expensively in-house or by outside contractors.

Senator **Danforth**. You don't think that's done under A–76?

Mr. **McCosker**. Let's say A–76 hasn't been enforced by the agencies. But where we really need help in legislation is to pass A–76 through to federally assisted programs.

Senator **Danforth**. Well, as I understand it, that is one of the provisions in Senator East's bill. As I said, I would be doubtful that at this time we are going to try to tell State governments or local governments how they should provide their public services. Maybe we will, but I would be very doubtful.

Mr. **McCosker**. You are closer to that, sir, than I. But the people want this, and you can see in Los Angeles what the savings have been. That's just in one area, one county.

Senator **Danforth**. Yes. Do you have anything to add, Mr. Eisenhour?

Mr. **Eisenhour**. Simply that the system does not have teeth in its accountability.

Senator **Danforth**. Thank you very much.

[Mr. McCosker's prepared statement follows:]

Testimony of

David A. McCosker

For

The Associated General Contractors of America

Presented to the

Committee on Government Affairs

Subcommittee on Federal Expenditures, Research and Rules

United States Senate

May 19, 1982

On the Topic of

Government Competition with Private Enterprise

AGC is:

- More than 30,000 firms including 8,400 of America's leading general contracting firms responsible for the employment of 3,500,000-plus employees;
- 113 chapters nationwide;
- More than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utility facilities;
- Approximately 50% of the contract construction by American firms in more than 100 countries abroad.

Good morning, my name is David McCosker, I am the President of Independent Construction Company in Oakland, CA. Today I am testifying for the Associated General Contractors of America as Chairman of AGC's Contract Construction Committee.

The Associated General Contractors of America (AGC) represents more than 30,000 firms including 8,400 of America's leading general contracting companies which are responsible for the employment of more than 3,500,000 employees. These member contractors perform more than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utility facilities.

AGC supports Senate Joint Resolution 93 and S.2278 which reaffirm the basic policy of government that it should not compete with the competitive free enterprise system and should rely on that system for the goods and services it requires. The expression of support for reliance on the competitive free enterprise system by both Houses of Congress should substantially bolster OMB's effort to implement its standing policy as expressed in OMB's Circular A-76 of reliance by direct federal awarding agencies on the private sector.

The issue of construction by government forces--In House construction--or as it is more commonly referred to "Force Account Construction" versus the use of private contractors-construction by contract--is not new. In fact, a trade publication in its August 13, 1914 edition contained an article discussing the pros and cons of the two methods in constructing sewers in New Orleans. The issue takes on particular significance in light of current public works expenditure reductions.

These reductions and the reduced amounts available to governmental units in general make it more important than ever before that public works monies be spent in the most efficient and economical manner possible. With fewer funds available for much needed public works projects, the taxpaying public has the right to demand that it gets the most for its money.

S.2278 will be a major step in this effort. S.2278 will require agencies to review their policies on in-house production following its enactment. Presumably, such an evaluation to comply with S.2278 will be undertaken following the provisions of A-76.

The passage of S.J. Resolution 93 and S.2278 is greatly needed. Despite the existence of Office of Management and Budget Circular A-76 which requires cost comparisons prior to the federal government considering initiating a commercial activity for the procurement of needed goods and services, federal construction agencies ignore strict utilization of A-76, and those agencies which provide federal assistance funds are not explicitly required to follow A-76.

For example, the Army Corps of Engineers has not performed any cost comparison studies pursuant to Circular A-76 during the last fiscal year - yet that agency conducts dredging and revetment work (laying a cement mattress on a river bed) with its own construction forces in the lower Mississippi Valley. Over $95 million of dredging and fully half of the $63 million of revetment projects was performed by in-house forces. The last cost comparison review was conducted during 1977 and 1978 when a substantial portion of towing of materials and equipment was converted to contracting out, according to the Corps. We believe more frequent cost comparison will result in more conversions and, more savings to the tax paying public.

Another, more blatant example of indifference to A-76 is the Tennessee Valley Authority. After receiving the A-76 Circular in 1967, the Tennessee Valley Authority defined its entire construction program as an "existing government activity," and waived the requirement for further review. As a result, TVA has exempted itself from the requirement to cost justify its force account construction.

We believe, that in the public interest as well as in the interest of fostering the government's policy of utilization of private enterprise, TVA should meet the requirements of OMB Circular A-76.

The taxpaying public has the right to have its funds spent in the most efficient and economical manner possible on ALL public works projects. The distinction between federal and federally-assisted construction programs should not be a reason to deny the security of comprehensive cost comparisons in protecting public expenditures from inefficient use.

For example, the Federal Highway Administration's publication entitled "Monthly Highway Construction Contracts Awarded by State and Federal Agencies and Toll Authorities" reveals the following disturbing figures:

> $120.9 million in federal-aid and direct federal construction was done by force account in calendar year 1978. Of that total, $102.2 million was federal funds.
>
> $125.8 million in federal-aid and direct federal construction was done by force account in calendar year 1979. Of that total $107.5 million was federal funds.
>
> $48.1 million in federal-aid and direct federal construction was done by force account through the first six months of 1980. Of that total $41 million was federal funds.

IN FACT, FHWA REGULATIONS AUTHORIZE THE USE OF FORCE ACCOUNT CONSTRUCTION UPON A FINDING (WITHOUT COST COMPARISONS) THAT IT IS IN THE PUBLIC INTEREST. THE PUBLIC INTEREST DEFINITION INCLUDES SITUATIONS WHERE THERE IS A LACK OF BIDS OR THE BIDS RECEIVED ARE UNREASONABLE. WE FIND IT DIFFICULT TO BELIEVE THAT ALMOST $300 MILLION IN FEDERAL HIGHWAY CONSTRUCTION WORK OVER A TWO AND A HALF YEAR PERIOD MET THIS DEFINITION.

WHILE WE COULD NOT OBTAIN ANY FIGURES WHICH SHOW HOW MUCH FORCE ACCOUNT WORK IS ACCOMPLISHED THROUGH THE ENVIRONMENTAL PROTECTION AGENCY'S CONSTRUCTION GRANTS PROGRAM, WE ARE CONCERNED THAT EPA'S REGULATIONS FOR THIS PROGRAM PERMIT THE USE OF FORCE ACCOUNT.

IT IS OBVIOUS FROM THESE EXAMPLES THAT COMPETITION BETWEEN THE GOVERNMENT AND THE PRIVATE SECTOR EXISTS.

WE BELIEVE TAXPAYERS WOULD PREFER BEING ABLE TO REVIEW COST COMPARISON STUDIES TO ASSURE THAT THESE MONIES WERE SPENT IN THE MOST ECONOMIC MANNER.

IN ADDITION TO PROVIDING THE MOST EFFICIENT AND ECONOMICAL MEANS OF PRODUCING PUBLIC WORKS CONSTRUCTION, CONTRACTING OUT PROVIDES A VARIETY OF OTHER BENEFITS TO THE PUBLIC IN THE FORM OF RISK SHIFTING, WHICH CANNOT BE OBTAINED UNDER IN-HOUSE PERFORMANCE. LET ME BRIEFLY REVIEW HOW SOME OF THESE RISKS ARE ALLOCATED WHEN CONSTRUCTION IS DONE BY CONTRACT:

-- THE PUBLIC ONLY PAYS FOR WHAT IT RECEIVES; WORK ACTUALLY PERFORMED IS THE BASIS OF PAYMENT.

-- THE PRICE IS FIRM AND GUARANTEED BY THE CONTRACT, AND THE PUBLIC HAS NO RISK OF COST INCREASES. ALL OF THE VARIABLES OF THE MARKET PLACE, SUCH AS INCREASES IN MATERIAL PRICES, WAGES AND SHORTAGES ARE BORNE BY THE PRIVATE CONTRACTOR.

-- TIMELY COMPLETION IS ASSURED BY A LIQUIDATED DAMAGE PROVISION.

-- FAITHFUL PERFORMANCE IS BACKED BY PERFORMANCE AND PAYMENT BONDS.

-- RISK OF DAMAGE DURING CONSTRUCTION IS BORNE BY THE CONTRACTOR, NOT THE PUBLIC.

-- THE CONTRACTOR MUST "DEFEND AND HOLD HARMLESS" THE PUBLIC AGAINST CLAIMS AND MUST PROVIDE THE PUBLIC WITH INSURANCE COVERAGE.

-- QUALITY INSPECTION IS AT "ARM'S LENGTH" BY INDEPENDENT INSPECTORS.

-- THE FINAL WORK IS WARRANTED AND DEFECTS MUST BE CORRECTED AT NO EXPENSE TO THE PUBLIC.

TO TAKE THESE RISKS AWAY FROM THE TAXPAYERS AND PUT THEM ON A PRIVATE CONTRACTOR WHO, THROUGH HIS PAYMENT AND PERFORMANCE BOND, GUARANTEES THE JOB WILL BE FINISHED ACCORDING TO THE TERMS OF THE CONTRACT, IS WORTH A GREAT DEAL IN DOLLARS. NONE OF THIS PROTECTION OF THE PUBLIC'S INTEREST EXISTS WHEN WORK IS PERFORMED BY A PUBLIC AGENCY WITH PUBLIC EQUIPMENT AND PERSONNEL -- ALL OF THE RISKS ARE ON THE TAXPAYER.

ANOTHER BENEFIT OF THE CONTRACT METHOD, OFTEN OVERLOOKED BY PUBLIC OFFICIALS, IS A RETURN OF PART OF THE CONTRACT PRICE TO THE PUBLIC TREASURY IN THE FORM OF TAXES. AN OREGON STUDY CONCLUDED THAT TAXPAYERS RECEIVE A NET RETURN OF 23.2 - 24.5 PERCENT OF THE CONTRACT COST WHEN CONTRACT CONSTRUCTION IS CHOSEN OVER FORCE ACCOUNT CONSTRUCTION. THIS INDIRECT COST REDUCTION TO THE PUBLIC IS NOT

FACTORED INTO COST COMPARISON COMPUTATIONS AND RESULTS FROM A VARIETY OF USE, EXCISE, EMPLOYMENT AND INCOME TAXES.

ALTHOUGH COST IS THE MOST IMPORTANT FACTOR IN DECIDING WHETHER TO CONTRACT-OUT OR USE IN-HOUSE FORCES, PUBLIC AGENCIES SHOULD ALSO BE AWARE OF THE SOCIAL IMPLICATIONS OF DOING THEIR OWN CONSTRUCTION. WHEN FORCE ACCOUNT ACTIVITIES START THE PUBLIC AGENCIES USUALLY BEGIN WITH SMALLER JOBS. AS THEIR FORCES GROW, THE SIZE OF THE PROJECTS GROW. IT IS THIS TENDENCY TO TAKE OVER SMALL AND MEDIUM SIZE PROJECTS WHICH MOST AFFECTS THE CONSTRUCTION INDUSTRY. WE ARE IN AN INDUSTRY MADE UP OF HUNDREDS OF THOUSANDS OF SMALL FIRMS. PERFORMANCE OF SMALL AND MEDIUM SIZE PROJECTS BY PUBLIC AGENCIES FORECLOSES IMPORTANT GROWTH OPPORTUNITIES FOR EMERGING SMALL FIRMS, INCLUDING MANY MINORITY OWNED FIRMS. BECAUSE OF LOW OVERHEAD COSTS THESE SMALL FIRMS ARE VERY COST COMPETITIVE. CONSTRUCTION BY FORCE ACCOUNT OF THESE SMALL AND MEDIUM SIZE PROJECTS DENIES SMALL FIRMS THEIR RIGHTFUL PLACE IN THE MARKET.

IT IS WELL KNOWN THAT SMALL BUSINESS GENERATES THE MAJORITY OF NEW JOBS IN THE COUNTRY, AS WELL. THESE FIRMS OFFER EMPLOYMENT EXPERIENCE IN SKILLED TRADES WHICH EQUIP AN INDIVIDUAL WITH EXPERIENCE THAT CAN PROVIDE AN EXCELLENT LIVING. IN CONSTRUCTION, MANY OF THESE SKILLED WORKERS EVENTUALLY BECOME CONTRACTORS THEMSELVES. THE EFFECT OF FORCE ACCOUNT CONSTRUCTION THEREFORE, IS TO FORECLOSE GROWTH OPPORTUNITIES FOR EXISTING BUSINESSES, DENY NEW FIRMS THE OPPORTUNITY FOR EXPANSION, DENY ENTRY EMPLOYMENT FOR MANY INDIVIDUALS AND TO PREVENT THOSE INDIVIDUALS FROM BECOMING SMALL BUSINESSMEN. THE IRONY OF HAVING A PUBLIC AGENCY PRODUCING THIS RESULT IS READILY APPARENT.

IN ORDER TO REINFORCE THE FEDERAL GOVERNMENT'S POLICY OF DEPENDING ON THE PRIVATE SECTOR FOR NEEDED GOODS AND SERVICES NOT ONLY FOR DIRECT FEDERAL PROCUREMENTS BUT FEDERALLY ASSISTED AS WELL, WE BELIEVE THERE ARE A NUMBER OF OPTIONS THAT EXIST. THE FIRST WOULD BE THE REVISION OF OMB CIRCULAR A-76 TO INCLUDE THOSE FEDERALLY ASSISTED ACTIVITIES INCLUDING FEDERAL LOANS AND LOAN GUARANTEES. THIS EXTENSION, WE BELIEVE, SHOULD ALSO INCLUDE ACTIVITIES OF THE FEDERAL FINANCING BANK. EXPANSION OF OMB CIRCULAR A-76 TO INCLUDE FEDERALLY-ASSISTED CONSTRUCTION WOULD ALSO PROVIDE MANY STATE AND LOCAL GOVERNMENTS THEIR FIRST EXPERIENCE IN USING COMPREHENSIVE COST COMPARISONS. CURRENTLY THERE ARE NO STANDARD COST COMPARISON PRINCIPLES IN PUBLIC SECTOR ACCOUNTING. WITH REDUCED BUDGET OUTLAYS, PUBLIC OFFICIALS HAVE AN INCREASED RESPONSIBILITY TO ASSURE THAT THE REMAINING FUNDS ARE SPENT IN THE MOST EFFICIENT AND ECONOMICAL MANNER. SKILLS DEVELOPED IN ADMINISTERING COST COMPARISONS IN FEDERALLY-ASSISTED PROGRAMS WOULD ASSIST STATES IN THE TRANSFER OF THOSE PRINCIPLES TO STRICTLY LOCAL PROJECTS, THUS ACHIEVING EFFICIENCIES SIMILAR TO THOSE AVAILABLE IN DIRECT FEDERAL PROCUREMENT. SO THAT THE POLICY IN A-76 IS CLEAR TO RECIPIENTS OF FEDERAL GRANTS AND FUNDS, WE BELIEVE THAT THE REQUIREMENT FOR ADHERENCE TO A-76 SHOULD BE INCLUDED IN OMB CIRCULAR A-102, UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS-IN-AID TO STATE AND LOCAL GOVERNMENTS.

ANOTHER OPTION AVAILABLE IS THE QUICK PASSAGE OF S.J. RESOLUTION 93. PASSAGE OF THIS RESOLUTION WILL SERVE AS A VEHICLE FOR FURTHER ECONOMIES BY ENDORSING EXPANSION OF OMB'S COST COMPARISON TECHNIQUES.

IN OUR OPINION THE BEST OPTION IS PASSAGE OF S.2278. PASSAGE AND ENACTMENT OF THIS PIECE OF LEGISLATION WILL, BY LAW, REQUIRE NOT ONLY DIRECT FEDERAL AWARDING AGENCIES BUT THOSE STATE AND LOCAL GOVERNMENTS WHICH RECEIVE FEDERAL AID TO PROCURE NEEDED GOODS AND SERVICES FROM RESPONSIVE AND RESPONSIBLE PROFITMAKING BUSINESS CONCERNS FOLLOWING COST COMPARISONS SIMILAR TO A-76.

AGC SUPPORTS ALL THREE OPTIONS THAT WE HAVE DESCRIBED, BUT WE BELIEVE THAT S.2278 REPRESENTS THE BEST VEHICLE THROUGH WHICH THE FEDERAL GOVERNMENT CAN REEMPHASIZE ITS POLICY OF DEPENDENCE ON THE PRIVATE SECTOR. THE PROBLEM OF FORCE ACCOUNT REQUIRES LEGISLATIVE RECOGNITION. PROMPT ENACTMENT OF S.2278 WILL GIVE THE PROBLEM THE RECOGNITION IT DESERVES AS WELL AS A SOLUTION.

Senator DANFORTH. We have a vote right now, and I will be back in about 15 minutes.

[Recess.]

Senator DANFORTH. Next we have James Hostetler and James McKevitt.

TESTIMONY OF JAMES HOSTETLER, OF CHAPMAN, DUFF & PAUL, MEMBER, COUNCIL OF SMALL BUSINESS AND THE COUNCIL ON PROCUREMENT POLICY, CHAMBER OF COMMERCE OF THE UNITED STATES, ACCOMPANIED BY CHRISTINE A. RUSSELL, ASSOCIATE DIRECTOR FOR LEGISLATION, SMALL BUSINESS CENTER, CHAMBER OF COMMERCE

Mr. HOSTETLER. Thank you, Mr. Chairman. My name is James Hostetler. I am an attorney with the law firm of Chapman, Duff & Paul here in Washington. I am appearing here today as a member of the Council of Small Business and the Council on Procurement Policy of the Chamber of Commerce of the United States. Accompanying me is Chris Russell, associate director for legislation in the chamber's Small Business Center.

On behalf of the more than 240,000 members of the chamber, I wish to express our support for S. 2278 and Senate Joint Resolution 93, which reaffirm the Nation's longstanding policy of Government reliance on the private sector for needed goods and services. There is nothing more frustrating to the taxpaying private sector than to find that one of its major competitors, the Federal Government, is also its customer and the Federal competitor can use its position to influence the buying decision and cause commercial and industrial work to be performed by Federal employees. As a consequence, all businessmen have a vital stake in eliminating Government competition with the private sector in providing needed goods and services.

As the business community sees it, the business of Government is to govern, not to compete with its taxpaying constituents by hiring Federal employees, whose salaries and facilities are paid for by taxpaying businesses, to perform industrial or commercial activities.

The range and diversity of these competitive commercial activities are staggering. Many have already been mentioned: printing, retailing, manufacturing audiovisual and media materials. But I would add other categories: research and development activities, employment services, laboratory testing and analytical services, professional services of all kinds, day care centers, camping, landscaping, and cleaning services, to mention a few. The service and support industries, particularly equipment and facility maintenance, are the hardest hit by Government competition.

The problem, as you know, is not new. In 1932, a study of the issue was made by a special committee of the House of Representatives. Since that time, numerous congressional committees and Presidential commissions have examined the problem and consistently advocated a strong policy of reliance on the private sector.

The present policy, as has been described by A-76, is inadequate insofar as it is, at the moment, full of contradictions and exceptions and lacks a clear congressional mandate. We cannot overemphasize the importance of giving the force of law to the policy that presently is on the books. I think everyone would agree that since 1955 the policy has been observed more in the breach than in the keeping, and the importance of congressional action is to give some clear direction that the administration and the executive branch must enforce the law.

The circular itself does recognize the major advantages of reliance on the private sector: its cost effectiveness, the managerial flexibility it provides with regard to manpower and changing priorities, and its ability to increase technology transfers.

However, in recent years, there has been an increasing trend away from the effective policy. Some of the reasons have already been stated: a flawed cost-comparison methodology and major exceptions. For example, governmental functions are exempt, with the definition of a governmental function left to the discretion of agency officials. It is not surprising that the private sector lacks confidence in how this and other exceptions are administered.

Reasons why executive agencies are biased in the direction of continuing or expanding in-house activities include: the inherent conflict faced by a person engaged in an activity deciding whether it should continue; a natural desire to maintain the position and strength of an office in terms of number of employees under the direct supervision of the manager; a distrust of the private sector's ability to perform capably for a reasonable price; and most importantly, strong political pressures from congressional and public employee sources not to open up a closed system to competition and businesslike performance measurements.

Although a strong philosophical and economic basis exists for the present policy, Congress has ignored this policy and legislated piecemeal restrictions to the present weak policy. For example, in this Congress, there is increasing evidence of a bias against reliance on the private sector.

S. 2248, passed recently by the Senate, the DOD authorization bill, prohibited the use of funds for contracting out firefighting and security services at military installations. In a colloquy between Senators Kassebaum and Jackson on the same bill, Senator Kassebaum indicated concern that the Mitchell amendment did not go far enough and recommended a 1-year moratorium on contracting out by the Defense Department. Senator Jackson supported that view and urged that the conferees adopt that position.

The House Armed Services Committee in the same DOD authorization bill—H.R. 6030—is recommending a 1-year moratorium on all contracting out. The military pay bill, as voted out by a subcommittee of House Armed Services, places severe limitations on contracting out.

What then is urgently needed is a congressional statement reaffirming and codifying a sound policy of reliance.

To conclude, the time for congressional action is long overdue. In 1955, the second Hoover Commission filed its report with 22 recommendations designed to eliminate or decrease substantially activities of the Government which competed with private enterprise. In 1972, the bipartisan Commission on Government Procurement strongly recommended legislation mandating such a policy. In 1978, the General Accounting Office, in a report entitled "Development of a National Make-or-Buy Strategy," strongly urged passage of legislation.

The U.S. Chamber commends the subcommittee and the chairman for providing an opportunity to address this issue. We would be glad to answer any questions that you may have. Thank you.

Senator DANFORTH. Thank you very much. Without objection, your full statement will be made a part of the record.

[Mr. Hostetler's prepared statement follows:]

STATEMENT
on
GOVERNMENT RELIANCE ON THE PRIVATE SECTOR
before the
SUBCOMMITTEE ON FEDERAL EXPENDITURES, RESEARCH AND RULES
of the
SENATE GOVERNMENTAL AFFAIRS COMMITTEE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
James Hostetler
May 19, 1982

My name is James Hostetler, attorney with the firm of Chapman, Duff and Paul in Washington, D.C. I appear today as a member of both the Council of Small Business and the Council on Procurement Policy of the Chamber of Commerce of the United States. Both seek to improve the procurement laws and policies of the federal government to assure more efficiency and cost effectiveness in the federal acquisition of needed goods and services. Accompanying me is Christine A. Russell, Associate Director for Legislation in the Chamber's Small Business Center.

It is a pleasure, Mr. Chairman, to appear before your Subcommittee to discuss the issue of government competition with the private sector of the economy.

On behalf of the more than 240,000 members of the Chamber of Commerce of the United States, I wish to express our support for S. 2278 and S.J. Res. 93 which reaffirm the nation's longstanding policy of government reliance on the private sector for needed goods and services.

The U.S. Chamber is the largest business federation in this country, representing more than 235,000 business firms, 2,700 chambers of commerce in this country and abroad, and 1,300 trade and professional associations.

A majority of these 235,000 business firms are small businesses. In fact, more than 97 percent of our member companies employ fewer than 500 persons, almost identical to the percentage of small businesses in the total economy. More than 60 percent of our members employ fewer than 20 persons, and more than 40 percent have less than 10 employees.

In view of these figures, it is fair to say that the U.S. Chamber represents the interests of American businesses, large and small, many of which do business with the federal government. There is nothing more frustrating to the taxpaying private sector than to find that one of its major competitors is also its customer and the federal competitor can use its position to influence the buying decision and cause commercial and industrial work to be performed by federal employees. Accordingly, we clearly have a vital stake in eliminating government competition with the private sector in providing goods and services needed by the federal government.

Federal Procurement Policy: Reliance on the Private Sector

The U.S. Chamber recognizes the significance of any proposed policy changes in federal procurement, which now involves more than one-tenth of the national budget. Government procurement has a major effect on the nation's businesses, their employees, government employees, and on a broader level, all American taxpayers. The policies ultimately adopted not only immediately affect the expenditure of $100 billion or more in taxpayers' money each year, but also will influence the government's procurement practices for years to come.

In view of these considerations, it would be difficult for us to overstate the importance of Congressional scrutiny of the impact of any proposed policy changes to ensure that they do, in fact, support the nation's longstanding policy of reliance on the private sector.

Reliance on the Private Sector vs. Government Commercial Activities

Competition with private industries by government agencies has long been a source of concern and has received increasing attention over the past few years.

According to recent General Accounting Office (GAO) estimates, federal employees currently perform 11,000 commercial or industrial activities that could be done by private firms. These activities cost taxpayers nearly $19 billion last year. Private firms are becoming more aware of the extent to which they are facing unfair competition from government sources -- at taxpayers' expense -- as well as competing with legitimate private sector sources.

For a small business already burdened by inflation, high interest rates and excessive regulations, government competition is often a crippling blow. For our starved economy staggering under these problems and a serious recession, the business that is currently being monopolized by the Government would be a life saver.

A 1980 Small Business Administration (SBA) Task Force Report estimated that federal in-house activities in 1977 numbered 21,130, at an annual operating cost of nearly $10 billion (more recent reports show twice that amount.) According to this study, the best estimate is that at least $2 billion annually would flow directly to small business if that $10 billion were contracted-out in approximately the same proportion as other activities presently being performed by contract.

The Task Force also estimated the potential annual savings to the taxpayer would average $2.98 billion. Clearly, small business is not the only likely beneficiary if federal in-house commercial or industrial activities can be reduced through greater reliance on the private sector.

In summary, as the business community sees it, the business of government is to govern, not to compete with its taxpaying constituents by hiring federal employees, whose salaries and facilities are paid for by taxpaying businesses, to perform industrial or commercial activities. The range and diversity of these competitive commercial activities is staggering: printing, retailing, manufacturing films, audio visual and media materials, research and development, employment services, travel services, laboratory testing and analytical services, professional services of all kinds, day-care centers, camping, landscaping and cleaning services. The service and support industries, particularly equipment and facility maintenance, are the hardest hit by government competition.

Some federal agencies, having acquired surplus equipment and manpower, even sell services such as research and computer programming to other agencies and in some cases, to the private sector.

This unnecessary growth of government competition undermines the private enterprise system and undercuts one of the nation's most valuable resources -- soundly conceived programs of scientific and technological research and development, which have been vital to our economic growth and to the welfare and security of our country.

History of Current Procurement Policy

The longstanding federal procurement policy has been, and continues to be, that the government should rely on the private sector for needed goods and services.

In 1932, a study of the issue was made by a special committee of the House of Representatives. Numerous Congressional committees and Presidential commissions have examined the problem in subsequent years and consistently advocated a strong policy of reliance on the private sector.

However, no formal policy was established until 1955, when the Eisenhower Administration issued a directive that the government should not provide services that put it in competition with private industry.

That policy was reaffirmed during the Johnson Administration by Circular A-76, issued by the Bureau of the Budget (predecessor of the Office of Management and Budget.) The policy has been subsequently revised several times, most recently in 1979 when OMB simply recognized the federal government as a competitor with private sources and set up a procedure to compare the cost of products or services in-house vs. private firms. This cost comparison is now required in every case even if the existence of highly competitive private sources should make the result inevitable. While OMB's circular A-76 reiterates the government's general policy of reliance on the private enterprise system to supply its needs, it is full of exceptions and contradictions and lacks clean Congressional mandate.

Advantages to the Public in Federal Policy of Reliance on the Private Sector

Circular A-76 was conceived in recognition of the major advantages of reliance on the private sector -- its cost-effectiveness, the managerial flexibility it provides with regard to manpower and changing priorities and its ability to increase technology transfers.

In most cases, the American taxpayer gets a much better deal under competitive contracts than when functions are performed in-house. Procurement experts have estimated that competitive contracts can reduce costs by as much as 25 to 50 percent and this level of savings has been confirmed by the Department of Defense (DOD) from its experience in implementing A-76.

For example, according to the Office of the Secretary of Defense, for Fiscal Year 1979, 1980, and part of 1981, DOD has conducted cost comparisons between in-house commercial activities and competitive contract performance. In 270 of these studies, contract performance proved to be more economical when contracts were awarded, producing savings of $209 million.

Contracting out, besides being more economical, also provides government managers with a greater degree of flexibility. Contracts can be awarded, terminated, and modified to provide goods and services, as needed, at the lowest cost; not so with a government facility or work force. The very nature of government and bureaucracy, with the attendant civil service regulations, make reductions in force -- after a function is completed -- difficult if not impossible. While government priorities change and shift constantly, federal employees hired for one purpose remain on the government payrolls years after the project for which they were hired has been completed.

Finally, when government research is performed by private firms, its application to civilian markets is accomplished more quickly. For example, the National Aeronautics and Space Administration's space program, which relies heavily on private sector research firms, has provided many useful consumer products as a spin-off. When research is performed in a government laboratory, commercial application is far more difficult.

It is essential that procurement policies and programs designed to further this progress in scientific knowledge and application take full advantage of the research capabilities of private enterprise, rather than establishing or expanding government facilities that compete with them.

Implementation of Current Federal Policy

However, as noted at the outset, in recent years there has been an increasing trend away from an effective federal policy of reliance on the private sector.

Some of the reasons have been noted already: a flawed cost comparison methodology and major exceptions to the basic policy. For example, "governmental functions" are exempt, with the definition of what is governmental in nature left to the discretion of agency officials. It is not surprising that the private sector lacks confidence in how this and other exceptions are administered. Reasons why executive agencies are biased in the direction of continuing or expanding in-house activities include:

1) the inherent conflict faced by a person engaged in an activity deciding whether it should continue;
2) a natural desire to maintain position and strength in terms of numbers of employees controlled;
3) distrust of the private sector's ability to perform capably for a reasonable price; and
4) strong political pressures from Congressional and public employee sources not to open up a closed monopolistic system to competition and businesslike performance measurements.

Potential disruption, delays and deterioration of service resulting from possible strikes by private sector unions is an often-cited argument against contracting out important commercial or industrial functions. But, when strikes have occurred, rarely has deterioration of service been experienced. Moreover, government union officials no longer can claim exemption from labor disruption given actual and threatened walk-outs by postal employees and air traffic controllers.

Alleged abuses in the procurement system -- such as year-end spending, individual and organizational conflicts of interest, and sole-source contracting -- have led to calls for greater controls over consultants and the invisible army of contracted employees. Unfortunately, this well-orchestrated movement is simply a subtle effort by those who oppose an effective policy of reliance on the private sector to maintain technical and professional work in-house within the government. It is ironic that at the very time Congress is trying to reduce barriers to international trade in services provided by the U.S. firms, it is unwilling to support strong measures to assure fair utilization of private organizational expertise by the federal government.

It is time to recognize the distinct limitations in the accountability of government -- at all levels. Government accounting systems are oriented toward outlays, not costs. No agency has a cost accounting system comparable to the cost accounting requirements for federal contractors. When an agency contracts for a product or service, there is a detailed accounting for all costs, in terms of the results provided.

Conversely, when an agency performs a task in-house, there is control only over the number of employees and the total dollars expended -- but no control over, or accountability for, output.

Finally, critics of contracting-out have made much of the large number of federal contractors and consultants. But the number of employees who may be involved in performance of federal contracts is immaterial; the fact that contract performance is more economical is the key point.

Preoccupation with the number of contract employees is irrelevant to the real issue -- economy in government. To begin with, there will never be a completely accurate account of contractor employees. Many are involved in providing the same product or service to private consumers; many contracts are awarded, and many others are completed each day. More significantly, many contracts are written in terms of the products or services to be provided and the cost to the government, not in terms of the number of people to be employed.

In a time of budgetary restraint, it is important that as functions are converted to performance in the most economical and efficient manner, careful planning and attention be given to the individuals who are affected by these changes. The Executive branch has met a high standard in this respect. Priority consideration is given to relocating employees displaced by decisions to convert to a contract method of operating. More importantly, contractors have been required to give affected federal employees the right of first refusal for jobs under a contract and the experience has been that few individuals are even displaced.

Congressional Policy: Less Reliance on the Private Sector

Although a strong philosophical and economical justification supports the policy of reliance on the private sector, Congressional consideration of the issue suffers from giving undue attention to the opposition of the unions representing federal employees. As a direct result of federal employee union pressure, Congress has ignored national policy and legislated piecemeal restrictions to the presently weak policy of reliance. In addition to examples already mentioned:

- In the 96th Congress, Section 502 of the DOD Authorization Act for FY '81 required detailed cost comparisons and impact studies which had to be certified by the Secretary of Defense and provided to Congress. This provision makes it more difficult for DOD to convert work being done by federal employees to more cost-effective private contracts. The House attempted to add a provision to the fiscal year 1981 Act allowing federal employees the right to seek judicial review and relief when contract awards "adversely affected" their jobs.

- In the 97th Congress, there is increasing evidence of anti-contracting out sentiment. S. 2248, the Senate passed DOD Authorization bill for FY '83, places a moratorium on conversion to the private sector of firefighting and security services at military institutions. The House Armed Services Committee has recommended (in its report on H.R. 6030, the DOD Authorization bill for FY '83) a one-year moratorium on all contracting out in DOD. The Military Pay bill as voted out by a Subcommittee of the House Armed Services Committee, also places severe limitations on contracting out in DOD.

What is urgently needed is for Congressional action to reaffirm and codify the sound policy of reliance on the private sector. Only then will a sound national policy begin to take hold.

Proposed Legislative Solutions

The Reagan Administration recently stated its position on contracting out, announcing full support for the policy of reliance on the private sector whenever possible. The Administration further stated that correct and vigorous agency implementation of OMB Circular A-76 policy will give taxpayers what they deserve - economy in government - and contribute significantly to the recovery of the national economy. Effective implementation of this policy can reduce the budget and projected deficit by billions of dollars, without eliminating or reducing a single program. It can also stimulate the private economy with billions of dollars of new business.

In June of 1981, Senator S.I. Hayakawa (R-Calif.) and Representative David Dreier (R-Calif.) introduced joint resolutions to address the government competition problem.

In March of this year, Senator John East (R-NC) introduced S. 2278, the Economy in Government Act. This bill is more specific and far-reaching than the previously mentioned resolutions. Senator East's bill also deals with the grave problems of indirect competition and state and local governments.

Conclusion

In 1955, the Second Hoover Commission filed its report with 22 recommendations designed to eliminate or decrease substantially those activities of the government which were competing with private enterprise. In 1972, the Commission on Government Procurement strongly recommended statutorily mandating a policy of reliance on the private sector to give greater force to the Executive branch's inadequate efforts to implement a sound policy. In 1978, GAO in its report entitled "Development of a National Make-or-Buy Strategy -- Progress and Problems" recommended that Congress pass legislation endorsing a national policy of reliance on the private sector. Innumerable Congressional hearings over the past 30 years confirm the need for Congress to act.

The U.S. Chamber commends the Subcommittee for providing this opportunity to address a critical initiative in achieving important national budgetary, management and procurement goals. I will be happy to try to answer any questions you may have.

Senator DANFORTH. Mr. McKevitt will be our next witness.

TESTIMONY OF JAMES D. McKEVITT, DIRECTOR, FEDERAL LEGISLATIVE AFFAIRS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, ACCOMPANIED BY SALLY DOUGLAS, ASSISTANT DIRECTOR OF RESEARCH, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. McKEVITT. Mr. Chairman, my name is Mike McKevitt, director of federal legislation, National Federation of Independent Business. Joining me today is Sally Douglas, who is assistant director of research for NFIB.

Our mandate vote in March 1980 reflected the fact that 67 percent of responding members voted in favor of the policy to require the Federal Government to contract out to the private sector for goods and services whenever and wherever it is cost effective.

The support of contracting out to the private, for-profit sector is based on two beliefs: (1) Contracting out affords the most effective and efficient method of providing needed goods and services; (2) Government's legitimate role is to govern; business' legitimate role is to produce goods and services. Government should not compete with its citizens.

Studies and personal experiences of our members indicate that Government competes with the for-profit private sector on a vast scale. A member of ours from California in the tire retreading business lost his contract with the National Guard as a result of their opening their own retreading plant in Utah. A member in Kansas wrote us of USDA county agents undercutting small retailers by selling seeds, chemicals, and so forth at cost. One of our members in Colorado complains about HMO's setting up their own pharmacies, optical centers. A member in Indiana finds himself competing with the Department of Energy in selling insulation. Our members in North Carolina, Alabama, and Arizona tell of the PX competing with small retailers selling stereos, washing machines, and so forth, at drastically reduced prices. A member in Indiana complains about students in the university operating their own grocery stores. A member in Ohio is in competition with HUD—the member rents tools to people; HUD provides them for free. A member in Illinois fights the U.S. Postal Service's plan to purchase and place in privately owned stores postage stamp vending machines in direct competition with businesses that have provided this service for over 40 years. A California member in the video production industry complains about competition from nonprofit, tax-supported organizations.

GAO reported an estimated 400,000 Federal employees currently operating over 11,000 commercial or industrial activities at an estimated cost approaching $19 billion annually. The same study also indicated that DOD cost comparisons already completed show more than half of their in-house commercial activities could be obtained more economically by contract.

Competition is not restricted to the Federal Government. State and local governments are also engaging in more and more in-house activity largely fueled by Federal funds.

As to nonprofits, another area of concern, Federal procurement policy seems to show an inherent bias favoring nonprofit concerns even when evidence indicates that small business can do a more efficient job. There is a bias in procurement policy against small business which must be corrected. Procurement policy since Eisenhower has been based on reliance on the private sector. It has never been fully or consistently implemented. Congressional action is necessary to establish and insure the implementation of this policy which emphasizes contracting out, which I will touch on in conclusion.

We, therefore, support Senate Joint Resolution 93, Senator Hayakawa's proposal to clarify and reaffirm the procurement policy of reliance on the competitive private enterprise system. We also support the intent of S. 2278, Senator East's bill to establish statutory policy on contracting out based on three essential components: (1) Agencies cannot start or conduct any commercial or industrial activity to provide goods or services if such goods and services are available in the private sector; (2) a clear distinction is to be made between for-profit and nonprofit private sector entities, with for-profits and particularly small businesses given a decided preference in the awarding of contracts; (3) State and local governments will play by the same rules as the Federal Government. No Federal funds will be used to start or conduct activities which compete with the for-profit private sector.

In closing, in answer to your question of the previous panel, I think GAO said it best as reflected in the quotation on page 10 of our testimony:

> Without legislation, the executive branch can continue to unilaterally shift policy emphasis. Congressional action can preclude such unilateral shifts and establish a stable national policy. Such action would provide the necessary incentive for Federal agencies to implement the policy with assurance that it could not be changed again without Congressional approval.

Thank you.

Senator DANFORTH. Thank you. Your full statement will be made a part of the record.

Let me present to you what I think are the issues that we will have to face. The first is that this administration is philosophically committed to providing greater latitude to State and local governments to conduct their own affairs as they see fit. This is clear to me. Inherent in the administration's New Federalism, inherent in the shift from categorical grants to block grants, is an assumption that while Uncle Sam might know how to do it better local governments and State governments are going to have the chance to do it their way. I believe that philosophical commitment applies regardless of what specific management policies State and local governments want to follow. It would be a little bit difficult for the administration or the Congress to explain why we are going to condition Federal grants on contracting out, even if it is the clearly preferable policy, while we are removing other Federal requirements from these same recipients.

Second, I think it is evident from today's testimony that the administration does not have a clear position on contracting-out legislation.

Third, I think that it can be argued that, after you eliminate contracting out by governmental recipients of Federal grants, this legislation is essentially a reiteration of A-76; why state in statute that which is already a matter of public policy?

I think those are the three basic questions or the three basic hurdles that have to be jumped before we can go forward.

Mr. HOSTETLER. Mr. Chairman, obviously I am not in a position to speak on behalf of the administration. I am aware, however, that the administration has taken a position in support of Senate Joint Resolution 93. I think that was in both testimony before the Senate Small Business Committee and the Joint Economic Committee by Mr. Stockman and also in a letter to Senator Hayakawa.

Mr. McKEVITT. I think Sally Douglas would like to respond to your point, Senator.

Ms. DOUGLAS. One of the basic problems on State and local aspects—I know you were mentioning that before, and it is an important point to us. It's not so much that we want the Federal Government to tell States and localities what to do, but President Reagan also has a very strong support for reliance on the private sector.

Now, there may be a difficulty in balancing some of the aspects of the New Federalism initiatives and this support of contracting out, but what we are saying is that what the bill does is make clear that within a rather broad restriction—in other words, within the restriction that the Federal money you get through a grants process per se—you will be subject to the same rules that your counterparts in Federal agencies are. One of the problems is having two groups playing by different sets of rules.

We are not asking for, in particular, a lengthy set of regulations per se on an activity-by-activity basis, but we would like to give an indication to States and localities to use the Federal money in this new initiative in the most cost-effective manner possible.

Mr. McKEVITT. Mr. Chairman, getting the horse to water and making him drink—what remedies do we have under A-76?

Senator DANFORTH. What remedies would you have under a statute?

Mr. McKEVITT. I think we would have a better remedy than we have now. Well, for one thing, I think it would maybe impose a little better attitude in the agencies. Take, for example, regulatory flexibility. I think we have seen a vast improvement—we have seen a significant improvement on regulations and the conduct of some of the agencies since the passage of the Regulatory Flexibility Act. I can cite some agencies like EPA and OSHA, for example. I know it isn't just because of Reg Flex. It's because of the people who are administering those agencies. I do think that this allows those people within the agencies to maybe be a little more cognizant of it.

Ms. DOUGLAS. Senator, also one more point needs to be made. We have a Government policy that has been kicking around for about 25 years that nobody is really paying much attention to. We have recently undergone a fight in terms of slow pay legislation. We tried to do that by regulation. We were not successful and needed to pass legislation. If you have the full force of law behind you, you have a clear congressional statement. I think it does give a very, very strong indication that we are quite serious about it.

Senator **DANFORTH**. For the slow pay problem, a specific remedy is provided: If you don't get paid on time, you collect interest.

Ms. **DOUGLAS**. There is a specific remedy provided also in the legislation, Senator East's legislation. There is a provision whereby a timetable is set up for not only inventorying all commercial and industrial in-house activities, but setting up a 5-year plan for gradual elimination.

It goes slightly beyond policy already. It gives an indication that we are not just making a statement here. We intend to do something about it. Under these broad guidelines, this is what you are to do.

Mr. **HOSTETLER**. Presumably, just to add one footnote to that, if a law is passed and if regulations implementing the law are on the books, and if the Federal Government—if the executive branch fails to adhere to those regulations, we do have a judicial remedy. At present, a determination under A-76 is not challengeable in court. There is simply no appeal process. There is no way in which we can seek relief at all. It is nothing but an executive policy, a statement of good intention.

[The prepared statement of Mr. McKevitt follows:]

NFIB National Federation of
Independent Business

STATEMENT OF

JAMES D. "MIKE" MCKEVITT
DIRECTOR, FEDERAL LEGISLATIVE AFFAIRS

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

BEFORE: Subcommittee on Federal Expenditures, Senate Committee on Government Operations

DATE: May 19, 1982

SUBJECT: Government Procurement

Mr. Chairman, on behalf of the National Federation of Independent Business (NFIB), which represents in excess of a half million small and independent businesses across the nation, I am pleased to appear before you today to comment on Federal procurement policy.

In a poll of our membership taken in March of 1980, NFIB asked whether the Federal government should be required to contract out to the private sector for goods and services whenever and wherever it is cost effective. Responding members' voted 67% in favor of such a policy. Our members' support for contracting out stems in large part from two basic beliefs: 1) contracting out is "good business practice," since it affords the most effective and efficient method of providing needed goods and services; and 2) the government's legitimate sphere of operation is to govern, while the legitimate function of business is to produce goods and services. The government should not compete with its citizens through in-house production of any goods and services which are readily available at reasonable prices in the for-profit private sector.

Not can it be said that our members' concern over the issue of contracting out vs. in-house production arises solely from abstract philosophical considerations, but from personal experience as well:

--a member from California in the tire retreading business lost his contract with the National Guard as a result of their opening their own retreading plant in Utah.

--a member in Kansas writes of USDA county agents undercutting small retailers by selling seeds, chemicals, etc. at cost.

--a member in Colorado complains about HMO's setting up their own pharmacies, optical centers, etc.

--a member in Indiana finds himself competing with the Department of Energy in selling insulation.

--members in North Carolina, Alabama, and Arizona tell of the PX competing with small retailers, selling stereos, washing machines, etc. at drastically reduced prices.

--a member in Indiana complains about students in the university operating their own grocery stores.

--a member in Ohio is in competition with HUD. The member rents tools to people--HUD provides them for free.

--a member in Illinois fights the U.S. Postal Service's plan to purchase and place in privately owned stores postage stamp vending machines, in direct competition with businesses that have provided this service for over forty years.

--a California member in the video production industry complains about competition from non-profit, tax-supported organizations.

These are only a few of the examples NFIB can cite of unfair competition by Federal agencies, the result in large part of the lack of a sound, consistent, and fully implemented government policy for procuring goods and services used in the public sector from for-profit commercial and industrial business concerns.

In 1952, President Eisenhower championed the principle of government reliance on the for-profit private sector for goods and services needed by the government, the basic message being that no Federal project would be undertaken by government employees which the private, for-private sector could effect. Formal adoption of the principle as Federal policy was achieved in the Bureau of the Budget (BOB) Bulletin No. 55-4, issued in January 1955, which included the following statement:

> It is the general policy of the Administration that the Federal Government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels.[1]

BOB Bulletin No. 55-4 is remarkable in its categorical commitment to reliance on private enterprise. In fact, the Bulletin went on to state that cost comparisons were not to be a factor except in such instances where a product or service could not be purchased on a competitive basis or at a reasonable price. What is most interesting are the three reasons cited for discounting consideration of government vs. private sector costs. First, government costs are by nature not comparable with business costs since, for example, the government pays no taxes. Secondly, government bookkeeping procedures are different from businesss accounting practices, making comparisons difficult and misleading.

Most important, justification of commercial activity on the part of the government on a cost basis "runs counter to the concept that the Government ordinarily has no right to compete in a private enterprise economy"[2] (emphasis added).

From this clear, simple statement of distinction between the proper role of the government (to govern) vis-a-vis the proper role of private enterprise (to conduct business), the Executive branch has modified by gradual stages over the ensuing years its policy of absolute reliance on the private, for-profit sector for goods and services required by the Federal government, ultimately reaching the point where, in 1979, the revision of the Office of Management and Budget (OMB) Circular A-76--the centerpiece of procurement policy--included language that clearly gave precedence to cost-effectiveness over reliance on the private sector, and further, negated any distinction between private, for-profit businesses and non-profit entities in terms of preference in awarding Federal contracts.

Despite these changes, the essential policy remains that the government should not compete with its citizens. Nevertheless, government does compete with the private sector, and on a vast scale. A recent study by the General Accounting Office (GAO) indicates that "an estimated 400,000 Federal employees are currently operating over 11,000 commercial or industrial activities at an estimated cost approaching $19 billion annually."[3] In other words, nearly one of every four employees of the Executive Branch civilian work force is currently engaged in activities which are clearly not of a policy, decisionmaking, or managerial nature, in direct competition with employees performing essentially the same activities in the private, for-profit sector. Yet a significant proportion of these activities cannot even be justified on a cost savings basis, in accordance with the dictates of Circular A-76. The GAO study points out that cost comparisons recently completed by the Department of Defense (DOD) "show that more than half of its commercial activities could be obtained more economically by contract."[4]

The growth of state and local governments, largely fueled by Federal grants and revenue sharing, is another matter of concern to small firms, for this growth is accompanied by a concomittant increase in government competition on yet another level. During the period of 1953-1970, state and local government employment grew from 8.6% to 14% of total non-farm payrolls. While much of the increase is attributed to education employment, non-educational state and local government employment also grew much faster than similar employment in the private sector--a 79% rate for government as compared to a 33% private sector rate.[5] Clearly state and local government competition with small business is on the rise and is supported by the growth in aid and revenue-sharing programs of the Federal government, programs which have had an average annual increase of 16% since 1965 and which amounted to $77.9 billion in 1978.[6] The chief difficulty with the grants program is its exemption from Federal policies such as A-76. For this reason, state and local government have little incentive to contract out for needed goods and services, for they are not even required to conduct cost comparisons to justify continuing in-house commercial and industrial activities. It is our belief that vigorous enforcement of A-76 within Federal agencies will solve only part of the problem of government competition with small firms. A second necessary step is to require state and local government recipients of Federal monies to conform to the same policies as their Federal counterparts. The increasing role of non-profits in activities which have always been performed by private enterprise is another matter of deep concern to many businesses, in particular small businesses which cannot hope to compete on an equal basis against the subsidized resources and tax-favored status of the non-profits. Clearly there exists in the Federal procurement process an inherent bias towards non-profits. Some of the bias exists as a result of legislative action to promote certain social goals, as in the case of sheltered workshops, which are given preferential treatment in the awarding of small business set-asides by the Wagner-O'Day Act as a means of assisting the blind and severely handicapped. Considerable evidence exists that the preference given sheltered workshops has not helped the handicapped community mainstream into the economic system, but rather has severely penalized the small business community and may have resulted in the exploitation of sheltered workshop employees.[7]

Equally puzzling is the decided preference given to universities in the awarding of Federal contracts and grants. For example, universities have been favored in the awarding of billions of dollars for research. Yet all the evidence indicates that small business, while receiving less than 5% of all Federal R & D dollars, has contributed almost 1/2 of major U.S innovations during 1953-1973.[8] In recent years the academic world has been the primary beneficiary of a wide array of Government-sponsored assistance programs, the bulk of the money for which often supports overhead expenses rather than being spent to assist clients as intended.[9] Even more distrubing is the use of grant monies for such things as construction of motels to be owned and operated by universities, particularly when motels are already present in the area.[10]

A final concern about current procurement practices needs to be made, and that is the apparent bias among Federal agencies against small business. This bias is reflected in a number of ways, two of the most notable being:

> --The inclusion of a number of provisions within the recent OFPP proposal for a uniform procurement system which would reduce or eliminate opportunities for small business to compete for Federal contracts.
>
> --The recent innovation at DOD--ostensibly to insure timely completion of the A-76 required cost comparisons--of consolidating individual base maintenance/service contracts into a single contract, thereby eliminating small firms' capability to compete effectively.

Small business has proven time and again that they can compete effectively for, and perform efficiently on, govenment contracts--as long as the deck is not stacked against them. A strong, sound national procurement policy must be devised in a way that insures maximum participation by qualified small businesses.

Congress has never passed a resolution or law to mandate reliance on the private sector for goods and services needed by the government. In recent years Congressional efforts to come to grips with contracting out has been stymied by repeated attempts by the Executive Branch to "study the issue" and by a growing controversy within Congress itself over the proper course of action to take, largely fueled by the concerns of public employee unions and by revelations of fraud and abuse within the procurement system. Such concerns led to the introduction in the last Congress of bills such as H.R. 4717, introduced by then-Representative Herbert E. Harris, and its re-introduction in this Congress by Representative Ferraro (H.R. 4089), ostensibly to treat the very real problem of year-end spending sprees and wasteful federal spending, but which would have the practical effect of terminating contracting out and increasing in-house production of goods and services.

We do not question the validity of claims that fraud and abuse exist within the procurement process. We do, however, believe that it is patently absurd to condemn all businessmen for the unscrupulous practices of some, and at the same time to hold all public employees blameless. James T. Bennett and Manuel H. Johnson point out numerous instances of bureaucratic waste and inefficiency in their excellent book, Better Government at Half the Price. Based on the evidence they uncover, the conclusion seems inescapable:

> Clearly, the private sector could not waste money on useless contracts if the contracts were not given by bureaucrats in the first place. It is not the private firm that solicits contract proposals; it is the bureaucrat. It is not the private firm that reviews contract proposals; it is the bureaucrat. It is not the private firm that awards the contract; it is the bureaucrat. It is not the private firm that monitors the work performed once a contract is awarded; it is the bureaucrat. The message cannot be over emphasized: the source of contract waste is the public sector, not the private sector.[11]

Reliance on the for-profit private sector for goods and services needed by the government makes good sense, philosophically and economically. Government competition with private enterprise promotes serious concern about the proper function of government in a free enterprise economy. Over the past twenty years, GAO has issued numerous reports on the contracting process, and repeatedly has drawn a marked distinction between the proper role of the government employee (basic management function) and the private sector (commercial/industrial function). NFIB wholeheartedly agrees. In-house production of goods and services translates into lost income for small businesses. Lost income means lost tax revenues, from both the business itself and from the employees the business would have hired to perform the additional work that a Federal contract would bring. Further, reliance on the private sector would result in significant cost savings to the Federal government. Bennett and Johnson's book includes numerous instances of cost comparisons between the private and public sectors for a wide range of activities. The inescapable conclusion is that the private sector is significantly more efficient in delivering needed goods and services than is the public sector. As one economist stated, such findings lead to the suggestion of a "Bureaucratic Rule of Two: Removal of an activity from the private to the public sector will double its unit costs of production."[12]

A strong commitment to private sector reliance for the provision of needed goods and services is essential. Therefore NFIB wholeheartedly supports S.J. Res. 93, to clarify and reaffirm, by legislative mandate, this basic policy of reliance on the competitive private enterprise system. We applaud the Chairman for his introduction of this resolution and promise NFIB's assistance in achieving enactment, for we believe, as GAO has stated:

> Without legislation, the executive branch can continue to unilaterally shift policy emphasis. Congressional action can preclude such unilateral shifts and establish a stable national policy. Such action would provide the necessary incentive for Federal agencies to implement the policy with assurance that it could not be changed again without Congressional approval.[13]

Enactment of a resolution such as S.J. Res. 93 is only the first step in establishing a statutory policy on contracting out. S. 2278 would take the process a much-needed step further, by establishing statutory provisions to insure a national procurement policy based on three essential components:

> --Except under certain specified conditions, no agency can start or conduct any commercial or industrial activity to provide goods or services if such goods and services are available in the private sector;
>
> --The distinction is clearly made between for-profit and non-profit private sector entities, and for-profit entities (with specific mention of small business being made) are to be given a decided preference in the awarding of contracts;

--The Federal procurement policy established in this bill will apply to state and local government entities by prohibiting their use of Federal funds for in-house production of goods and services.

While NFIB has some concerns about S.2278 as currently written, we wholeheartedly support the intent of the bill and urge the Subcommittee to consider it as a useful foundation upon which to build a much-needed, strong, mandatory procurement policy of government reliance on businesses--particularly small businesses.

ENDNOTES

[1] Small Business Administration, Government Competition: A Threat to Small Business (Washington, DC: Office of the Chief Counsel for Advocacy, 1980), p. 60.

[2] Ibid., p. 61.

[3] U.S. General Accounting Office, Civil Servants and Contract Employees: Who Should Do What for the Federal Government? FPCD-81-43 (Washington, DC: Comptroller General of the United States, June 19, 1982), p. 15.

[4] Ibid.

[5] Ibid., p. 98.

[6] Ibid., p. 110

[7] Small Business Administration, Competition.

[8] Office of Management and Budget, Small Firms and Federal Research and Development (Washington, DC: Office of Federal Procurement Policy, March 10, 1971) as reported in Joint Hearings on Small Business and Innovation, August 9-10, 1978 (Washington, DC: Select Committee on Small Business and the Committee on Small Business) p. 432.

[9] See, for example, the report by U.S. General Accounting Office, EED-79-113 (July 24, 1979) on expenditures in the Small Business Development Center program.

[10] Small Business Administrattion, Competition, p. 145.

[11] Bennett, James T. And Manuel H. Johnson, Better Government at Half the Price (Ottawa, IL: Caroline House Publishers, Inc., 1981), p. 85.

[12] Ibid., p. 37.

[13] U.S. General Accounting Office, Civil Servants, p. 26.

Senator DANFORTH. Thank you all very much. Next we have Frank Swain.

TESTIMONY OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION

Mr. SWAIN. Thank you, Senator. It is a pleasure to appear before this subcommittee and have the opportunity to participate in your review of Federal procurement policy, and in particular Government competition with small business. My office is certainly very much aware of your longstanding interest in this subject. Of course, as you know, the successful passage of the Prompt Payment Act is a great help to small business, and you are to receive well-deserved commendation for that.

I think that the current issue is probably as significant to small business as the prompt payment issue in terms of heightening the ability of small businesses to do business with the Federal Government.

Small business needs a simpler procurement policy that does not reward only those who understand its complexity. We need a procurement policy that acknowledges the efficiency, quality, and cost-effectiveness of small businesses.

As much as this subcommittee can accomplish in your review of legislation to draft a uniform Federal procurement system, you can equal or better the benefit for small business by establishing a clear statement of congressional intent favoring contracting out whenever feasible.

In testimony before the Senate Small Business Committee last November, and testimony which received a specific imprimatur of the administration, I endorsed Senate Joint Resolution 93 and the reasons for its enactment. Also in the statement made before Mr. Sowle, Administrator of OFPP, in December, I suggested that the Proposal for a Uniform Federal Procurement System was deficient to the extent that it did not include more provisions related to contracting out and the necessity for doing so.

I welcome this subcommittee's attention to the issue. The small business community would benefit directly and quickly as a result of an improved and tighter policy with respect to contracting out.

I don't think that there is any doubt that the President strongly supports the maximum use of the private sector, and particularly small business, in providing goods and services to the Government. The President specifically endorsed that approach in his recent report to the Congress on the state of small business.

And to which previous witnesses have no doubt alluded, previous OMB studies have indicated the numbers of commercial and industrial activities currently undertaken by the Government. The administration is taking action in this area. Circular A-76, which basically requires resort to the private sector whenever possible, was significantly revised in 1979.

OMB recognizes that the circular now continues to have some shortcomings and, of course, as you are aware, has proposed further changes to the current circular.

Despite these efforts of OMB and the very fine efforts of some agencies to involve small business and the private sector in their activities, we still have much to accomplish in this area. We recently calculated the Federal Government's percentage of award of procurement to small firms and found that for fiscal year 1980 only 19 percent of prime award contract dollars went to small business. In fiscal year 1981, this slipped to 18 percent.

Clearly, if we are looking toward a mechanism to open up the procurement process to small business, if we are in an era where we are saying we are going to look less at programs and more at the basic rules and regulations and try to enhance the opportunities for small firms, I think that some sort of clear congressional statement of intent on the contracting-out issue is going to be of benefit to small businesses seeking to do business with the Federal Government. These small businesses may be deterred from doing so by technical classifications made by people involved in interpreting and carrying out A-76 vis-a-vis small businesses which don't have the time or wherewithal to hire attorneys to get involved in the process. As Mr. Hostetler just indicated, even if they were to hire the attorneys to challenge these classifications and decisions, they don't necessarily have the right of action at this point.

In this regard, your efforts are a step in the right direction, and I wish to commend this committee and its members as well as the authors of this legislation under consideration this morning.

Basically, you have heard it all before from more eloquent witnesses than myself. We would like to reiterate that we think this whole contracting-out issue is a very major procurement issue for small business. I think it is an issue that does bear focus and discussion here at the congressional level as well as the administrative level.

We are really talking about a tremendous situation where about $110 billion a year in Federal procurement is transacted each year, and I think that it is absolutely necessary that the procurement process governing those transactions be as simple and as open as possible for all businesses, and particularly for small firms. Under this type of legislation, the Government would learn to rely more on small firms, and the taxpayer would probably be the ultimate beneficiary both in terms of better and more efficient products and in terms of better investment of the taxpayer dollar.

I'd be happy to take any questions.

Senator DANFORTH. Thank you. Your statement will be made a part of the record.

You say that the administration does support the Hayakawa bill?

Mr. SWAIN. The administration, yes, is on record in favor of Senate Joint Resolution 93.

Senator DANFORTH. Does the administration have a position on the East bill?

Mr. SWAIN. We sent our statement over late yesterday, and the official response was that it wasn't sent in time for an official position to be developed. So I would say at this juncture the administration does not support the East bill. I have not been told whether or not that lack of support is anything more than lack of analysis, rather than a reasoned decision to oppose it. I really can't say.

Senator DANFORTH. Do you have any feeling on the relation between attempting to mandate contracting out by State and local government grantees and the so-called New Federalism?

Mr. SWAIN. That's clearly the stickiest part of the East bill. I think that is an issue that ought to be discussed because so much of Federal procurement is transacted through the grant and contract mechanism at the State and local level. The East bill clearly could use some fine tuning in terms of that and some other issues involving de minimis exemptions or something to that effect.

I don't think that the administration is going to be in a very good position to give a blanket endorsement to the East bill when confronted with its principles of New Federalism, as you outlined in your question, and I believe that the $64 question is whether or not, in this specific instance, the Congress feels that it is of sufficient necessity to impose a statutory set of conditions.

Senator DANFORTH. That is precisely the argument for requiring any action by State and local government grantees. In fighting the battle of the block grant, you must face one specific case after another. Each time heartrending examples are used in favor of some specific requirement.

Mr. SWAIN. Let me put it this way, Mr. Chairman. I would hate to see progress on this sort of discussion stymied entirely by a discussion of the federalism issue.

Senator DANFORTH. Do you believe, in proceeding on the Federal contracting-out issue, that what the Federal Government does is a pretty good start?

Mr. SWAIN. That would be a major step in the right direction. Yes, sir.

Senator DANFORTH. Do you think that the East bill puts any teeth in the contracting-out policy, or is it just a congressional statement?

Mr. SWAIN. The real question is whether A-76 has any teeth in it, or whether there are any teeth in it that are doing anything but biting small business as opposed to biting the Government. I haven't looked into the technicalities of what sorts of rights of action the East bill would create in terms of a private right of action.

Clearly, if you are talking about legislation—and if there is a statutory standard, and someone accuses the Federal Government or an agency of doing something that doesn't fit that statutory standard, then I would assume that there would be some sort of injunctive rights by which a court could be requested to stop the particular activity because it wasn't in accordance with the regulation. I don't think those enforcement rights are available under A-76 as currently drawn.

But let me reiterate Mr. McKevitt's point. To some degree, it is, I think, synonymous or related to the experience under Regulatory Flexibility. There are a number of agencies that are making some real efforts at this point to make some analysis of the impact that proposed rules have on small business and to change some of those rules.

That has only happened within the last several months despite the fact that in 1978 President Carter put out what he called an Executive memorandum asking agencies to do this. The fact that there is a statute on the books that acts as a standard of law rather than a policy under which you are answerable to OMB, when they are not busy with something else or when they have somebody that is willing to dig into the technical issue that your agency is involved in—I think that it is always preferable for Congress when it feels strongly enough about an issue to statutorily mandate a policy rather than to rely on administrative policy statements or regulations.

As an example, the prompt payment situation: OMB officials were saying, "We think we can handle this by fine tuning our procedures and by changing our regulations," but Congress felt that it was necessary to enact a statute in that case.

Let me give you a case example in this area. I am holding an RFP, a request for proposal. This RFP is about 3 inches thick, a fairly thin one by the standards of the contractor who brought it by my office last week. It was issued by the Charleston Naval Systems Command, and although it is not exactly on the issue of contracting out, it does represent a situation called bundling, an increasing concern of contractors contacting our office.

In this proposal, the Naval Command is putting together about 20 different routine base maintenance activities—everything from operation of the mess halls to cleaning uniforms. The problem with bundling these functions all together is that they preclude anybody from bidding on specific sections of it. You have to come in and bid on the whole thing and be prepared to carry out every single task. Only a few contractors, or none, have the widely varied expertise to bid on and execute all of these activities. The result is that, if no responsive bidders are found, all of these activities will not be contracted out. The result is that bundling becomes a technique for barring contracting out and protecting military jobs.

Well, I think that is indicative of the sorts of problems that these small firms run into in trying to do business with the Federal Government. It is indicative of the absolute lack of bargaining power small businesses have—lack of legal bargaining power and lack of substantive bargaining power to get the system changed or to do anything but swallow the dictates of the procurement officer.

We're talking about a fairly big issue for small businesses here, and I think it is something that the Congress could, in making a statement, send a signal to the Federal agencies that you're not exactly satisfied with their record so far.

Senator DANFORTH. Thank you very much, sir. Very well done.

Mr. SWAIN. Thank you, Mr. Chairman.

[Mr. Swain's prepared statement follows:]

SBA U.S. Small Business Administration Washington, DC 20416

STATEMENT OF

FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY

U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

SUBCOMMITTEE ON FEDERAL EXPENDITURES,

RESEARCH AND RULES OF THE

SENATE GOVERNMENTAL AFFAIRS COMMITTEE

May 19, 1982

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

Thank you for the opportunity to participate in your review of Federal procurement policy. As you know, the Office of Advocacy has a long history of involvement in procurement issues, and particularly in the matter of government competition with private business.

Small business needs a simpler procurement policy that does not reward only those who understand its complexity. We need a procurement policy that acknowledges the efficiency, quality and cost-effectiveness of small businesses. As much as this subcommittee can accomplish in your review of legislation to write a Uniform Federal Procurement System, you can equal or better the benefit for small business by establishing a clear statement of Congressional intent favoring contracting out in the first place.

In testimony last November before the Senate Small Business Committee's Subcommittee on Advocacy and the Future of Small Business, I indicated my strong support for modification of existing policy. Let me reiterate today: it is not a function of the Federal government to compete with small business. Rather the Federal government must rely on competitive private enterprise to supply needed goods and services. Your bill proposes a solution to this small business problem. I welcome your attention to the issue. The small business community would benefit directly and quickly as a result of an improved and tighter policy with respect to contracting out.

I am proud to say that President Reagan strongly supports maximum use of the private sector, and particularly small business in providing goods and services to the government. In his March 1982 report to Congress on the State of Small Business he states:

> "The Administration has made a major priority of withdrawing wherever possible from competition with private industry in providing goods and services to be used by the Federal government. Activities of all departments and agencies are being examined to see which can be converted to the private sector. For instance, in a review of 440 activities conducted by military departments, it was found that 264 of these, or 60 percent, could be turned over to private enterprise. As these and other requirements are filled by the private sector rather than government itself, a principal beneficiary will be small business." 1/

Small business has a vital stake in this issue. An OMB study estimates that Federal employees operate over 11,000 commercial or industrial activities at a cost of almost $19 billion annually. 2/ This practice puts a strain on the private

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1/ The State of Small Business: A Report of the President, March 1982, page 17.

2/ OMB study, as cited in GAO report FPCD 81-43, Civil Servants and Contract Employees: Who Should Do What For the Federal Government, June 19, 1981, page 15.

sector, dries up small businesses, increases costs to the government, decreases vital tax revenues and some speculate may be eroding our defense mobilization base.

The Administration is taking action in this area. Circular A-76, which basically requires resort to the private sector whenever possible, was significantly revised in 1979. As implemented, the amended Circular has two defects:

1) Cost comparisons are required as a precondition to mandatory reliance on the private sector. Otherwise, the agency maintains discretion to contract out or not. Furthermore, these cost comparisons fail to take into account certain costs to the government: fringe benefits, overhead costs, reduction of tax revenues. The result is a bias in the formulae against contracting out.

2) National security and government functions are not defined by the Circular. As a result, some small businesses have informed our Office that some agencies expand these definitions beyond reasonableness to justify not contracting out commercial and industrial work.

OMB recognizes these shortcomings and is currently revising the Circular. These changes are technical and complex and do not lend themselves well to extensive discussion here. More important than any single provision is the signal OMB will send to the agencies with these changes that the President is determined to effect greater reliance on the private sector in the procurement of goods and services.

Despite these efforts of OMB, and the very fine efforts of some agencies to involve small business and the private sector in their activities, we still have much to accomplish in this area. In FY 1980, the Federal government awarded 19 percent of the prime award contract dollars to small business. In FY 1981, that figure dropped to 18 percent. 3/ The fact that the government-wide small business prime contract dollar share is falling should be a critical concern to all of us.

In that regard, your efforts are a step in the right direction, and I wish to commend this Committee and its members, as well as its authors for the interest and commitment in this area.

If you have any questions, I will be happy to try to answer them. I would like to note that time has not allowed OMB an opportunity to advise on the relationship of this statement to the President's program.

3/ Tabulated by the Office of Advocacy from figures obtained from the Department of Defense and the Federal Procurement Data Center. The figures are based on civilian and non-civilian procurement totals: $135.47 billion in FY 1981 and $111.25 billion in FY 1980. Excluding DOD non-business procurements, the government wide prime contract total for FY '81 is $117.44 billion, of which 20.9 percent went to small business.

Senator **Danforth**. The next witnesses are Earl Hess and Benjamin Cooper.

TESTIMONY OF EARL H. HESS, DIRECTOR OF GOVERNMENT RELATIONS, AMERICAN COUNCIL OF INDEPENDENT LABORATORIES, AND PRESIDENT, LANCASTER LABORATORIES, INC., LANCASTER, PA.

Mr. **Hess**. Thank you, Senator Danforth. I appreciate the opportunity to appear before you and the attention that you are giving this matter today.

First of all, I am founder and president of Lancaster Laboratories, Inc., a business which is now 21 years of age and has grown to a size of about 60 persons. I might indicate that this 21-year experience represents a game of strategic planning, developing areas into which I could expand and in which Government competition was not such a major problem so as to eliminate the possibility for me to succeed in those areas.

Independent laboratories, such as our company, are for-profit, mostly small businesses that offer professional services in the research, analytical, and testing fields. We are one of the subgroups of that larger group of small high technology companies about which so much has been said recently concerning their contribution to innovation. I think that I would like to point out that the need for the preservation of small businesses of the type that I represent is not just in the self-interest of these companies but also because of the central and catalytic role that they play in economic development through technological innovation.

The American Council of Independent Laboratories is a professional trade association of about 250 laboratories such as our own. It was established in 1937. One of its prime reasons for coming into existence was the subject of our hearings this morning.

I have spent an immense amount of time over these last 21 years acting in a rather defensive manner, coming here to testify or to deal with Government agencies, trying to block invasion of the Government or the nonprofit institutions into our business.

There has been a bit of a turn of events in the last 5 years in that at least some initiatives have been taken that would allow us to see some light at the end of the tunnel.

In 1978, I was invited to appear before a joint Small Business Subcommittee hearing on the underutilization of small business in the area of industrial innovation, and we identified at that time, at least for the laboratory community, the problem of Government competition with us as one of the major deterrents to our viability.

In 1979, the SBA Advocacy Task Group was formed. I was privileged to serve on that task force. I think that its report will be a part of your record.[1] It gives a host of examples, including many from the laboratory community, of Government competition.

Then came the White House Conference on Small Business. I would remind you that of the 60 recommendations coming out of that White House conference three of them dealt specifically with the subject and the problems of small business and Government competition.

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[1] See p. 125 for the Foreword, Digest, and Table of Contents of the report. The report in its entirety is retained in the subcommittee files.

It seems to me that the change in political climate that occurred at the end of 1980 gave me strong hope that there was a general wind blowing in Washington that was sympathetic to my position; that is, a switch away from big Government with greater reliance on the private sector.

Therefore, I was encouraged to see more attention being given to OMB Circular A-76, and particularly encouraged to see Senator Hayakawa introduce his Resolution 93. During the course of hearings held on that legislation, three independent laboratories testified. I gave probably the most comprehensive testimony on behalf of the American Council of Independent Labs, and my written testimony today refers back to that statement.

I give in today's statement a few specific examples that I would hope you might look at—one in the area of water testing where independent laboratories play, I think, a very important role in safeguarding our national health. In order to be able to perform these kinds of tests, such small businesses invest heavily in professional staff; they invest heavily in equipment and in all kinds of Government certifications to be qualified and certified to perform such work, only to find our State governments, our local governments, and seemingly everybody else competing with us—each of these wearing lighter weight gloves than we have in the private sector in the competitive match.

I would like to highlight the weakness of A-76 with one example where a request for proposal for water testing went out from USDA, obviously because they were forced to do it by reason of A-76—well, the whole thing became kind of a charade.

Let me simply wrap up by trying to make the point that there is one distinctive feature of the East bill that I would like to emphasize; namely, that it specifies contracting out to for-profit businesses rather than contracting out to anyone other than the Federal Government.

I think if you examine my testimony, the concerns that we have with respect to competition, especially from the academic community engaged in, shall I say, strictly proprietary work which represents an abortion of the purpose for which they are granted nonprofit status, you will understand that there is a dimension of the East bill that is very important to us in the small business community, especially independent laboratories.

Senator DANFORTH. Thank you, Mr. Hess. Without objection, your testimony will be included in the record.

[The prepared statement of Mr. Hess and the preliminary pages of the report, "Government Competition: A Threat to Small Business," follow:]

STATEMENT OF

DR. EARL H. HESS, PRESIDENT
LANCASTER LABORATORIES, INC.

before the

SUBCOMMITTEE ON FEDERAL EXPENDITURES,
RESEARCH AND RULES
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

on

GOVERNMENT RELIANCE ON THE PRIVATE SECTOR
and
GOVERNMENT COMPETITION WITH PROFITMAKING BUSINESSES

May 19, 1982

I am Earl H. Hess, founder and President of Lancaster Laboratories, Lancaster, Pa. For the past 21 years, Lancaster Laboratories has been providing research, development and analytical services to private-sector companies, private citizens, and to government at various levels. Beginning with three persons, our company has grown steadily to a present staff of 60, nearly half of whom are degreed professionals, mostly in the fields of chemistry and biology. We opened a branch laboratory in Waynesboro, Pa, in 1978. In its 21-year history, our company has never laid off an employee for lack of work. Further, during the last 18 months we have committed about $800,000 to expanded facilities and new equipment.

Although independent laboratories differ in size and in types of work, our company is generally typical of the several thousand independent commercial testing and analytical laboratories in the U. S. The American Council of Independent Laboratories (ACIL), which I represent today as its Director of Government Relations, is the professional association of these engineering and scientific firms; more than 250 companies belong to ACIL. Most ACIL laboratories are part of the group of small, independent, high-technology businesses that many studies have found to be the most fruitful source of innovative products and processes.

In addition to my association with this professional trade group, I hold various Chamber of Commerce positions: member of the Small Business Council of the U. S. Chamber of Commerce; Chairman of the Pennsylvania Small Business Advocacy Council (PASBAC), a division of our State Chamber; and Vice Chairman, Public Affairs of the Lancaster Chamber of Commerce. I am also a member of the Action Council of the National Federation of Independent Businesses (NFIB) and serve on the Advisory Council of the Pennsylvania Technical Assistance Program (PENNTAP), a model organization dedicated to technology transfer, mainly to small businesses.

It would be an understatement for me to say merely that the American Council of Independent Laboratories supports S. 2278, the Economy in Government Act of 1982. The fact is that ACIL enthusiastically and wholeheartedly endorses the legislation, the principles underlying it, and those unique elements that represent considerable advances over current government policies. Also, we congratulate and commend Senator East and Senator Hayakawa for introducing this bill.

The principles on which S. 2278 rests are both critical and incontrovertible. The first is that government should not compete with its citizens. The second is that the private sector produces goods and services more efficiently and economically than does the government. The truth of the latter point and the explanation for it are well documented in the excellent book: Better Government at Half the Price, by James T. Bennett and Manuel H. Johnson (Caroline House Publishers, Ottawa, IL, Copyright 1981).

These principles have guided ACIL since its founding in 1937. The greatest single impetus for the formation of our organization, in fact, was the growing incidence of competition in the testing field from government and government-supported entities. Over the past 45 years, officials of ACIL have testified at numerous hearings like these and held countless meetings with representatives of various Federal agencies. Almost without exception, at these hearings and meetings, ACIL has raised the issue of unfair competition from the government.

Until recent years, when ACIL made a formal appearance or presentation in Washington, it was usually reacting to a new bill or proposal that threatened to extend and expand the menace of government competition. Fortunately, in recent years, there have been some positive initiatives.

In 1978, subcommittees of the Senate and House Small Business Committees held hearings on Underutilization of Small Business in the Nation's Efforts to Encourage Industrial Innovation. Along with another member of the ACIL community, Dr. Charles Garber, of Structure Probe, Inc., West Chester, PA, I was invited to testify at these hearings. We pointed out that one way to improve the nation's innovation performance would be to take steps to curb the many forms of unfair government competition which are obstacles to small innovative companies like independent laboratories.

In 1979, the Office of the Chief Counsel for Advocacy of the Small Business Administration established a task group to study the subject of government competition with small business. I was one of several ACIL officials who served on that body. We found that government competition is prevalent in an astonishing range of small-business sectors - from audio-visual products and services to transportation - and that "the preference for the private sector, which is so consistent with our history and practice, has suffered so much decline for no satisfactory reason." The findings of the task group were published in March, 1980, under the title: Government Competition: A Threat to Small Business.

A major event in January of 1980 was the White House Conference on Small Business. ACIL was well represented there, and one of the several delegates from member laboratories was Dr. Fred Albright, Vice President and Technical Director of Lancaster Laboratories. Nearly 2000 delegates deliberated for a week and considered thousands of proposals to assist small business. In the end, they formally adopted 60 Conference recommendations and submitted them to President Carter for action. Three of the 60 addressed the subject of these hearings. They follow:

> The Federal Government shall be required by statute to contract out to small business those supplies and services that the private sector can provide. The government should not compete with the private sector by accomplishing these efforts with its own or non-profit personnel and facilities.
>
> The Federal Government should contract out supplies and services to private industry (particularly small and minority business) and should not compete with the private sector either through the use of its own personnel or through non-profit organizations such as the Federal Research Centers, educational institutions or other non-profit entities.
>
> Existing Federal research and development procurement, assistance, and tax laws and policies must be modified and new laws enacted to : 1) eliminate unfair advantages enjoyed by governmental agencies, non-profit

organizations and educational institutions which compete with innovative small business in providing goods and services and, 2) mandate statutorily a national policy of reliance on small business, 3) prevent the Federal government from disseminating proprietary information, 4) prevent the Federal government, through the use of its own personnel including Federal Research Centers, from competing with small business.

Last year, ACIL applauded the introduction by Senator Hayakawa and Representative Drier of their Joint resolution (S.J. Res.93, H.J. Res.294) stating that: "It is the policy of the Government of the United States to rely on competitive, private industry to supply the products and services it needs." When Senator Hayakawa, Chairman of the Subcommittee on Advocacy and The Future of Small Business of the Senate Small Business Committee, subsequently held three hearings on Government Competition with Small Business, testimony was presented by the owners of three profitmaking independent laboratories: Gene Zerlaut, of DSET Laboratories, Phoenix, AZ; Dr. Charles Evans, Charles Evans & Assocs., San Mateo, CA; and myself. I believe we made a convincing case for the seriousness of this problem and the need for radical remedies.

My statement in behalf of ACIL at the Hayakawa hearings on June 24, 1981 in Washington was quite comprehensive. Rather than duplicate it here, I respectfully request that it be entered in the record of these hearings. To that statement, I wish to make two additions: a description of some recent experiences of Lancaster Laboratory that illustrate the kinds of problems that government competition creates for independent laboratories; and some comments about those provisions of the Economy in Government Act of 1982 that make this legislation particularly constructive in the opinion of the American Council of Independent Laboratories.

One area where government competition continues to be particularly frustrating to us at Lancaster Laboratories is water and waste-water testing. Our laboratory and the scores of other independent laboratories that do this work have played a major role in assuring the quality of both public and private drinking water and in monitoring the quality of waste-water discharges. We have invested heavily in after-tax dollars in sophisticated laboratory facilities and instruments and in qualified personnel to meet the most stringent requirements of the Environmental Protection Agency (EPA) and various state certifying bodies. Yet in developing a market base for our services, we compete directly with the Pennsylvania Department of Environmental Resources for the bacteriological testing of private waters, as well as with certain municipal laboratories that not only perform their own analyses, but also work for outside clients. Our Franklin Division is located near the Pennsylvania-Maryland border; even though it is certified by EPA, it is denied access to its markets in Maryland and West Virginia because their Federally-approved state-operated laboratory accreditation systems make no provisions for either granting reciprocity or accrediting out-of-state laboratories. Efforts to correct this situation over the past two years have been fruitless. In fact, when EPA asked for comments on the reauthorization of the Safe Drinking Water Act (SDWA), early this year, ACIL stressed the need for attention to this serious shortcoming. In its 30-page summary of comments, EPA completely ignored our concern.

Further, the EPA construction grants program, with its high percentage of Federal dollars, has resulted in most municipal water and waste-water treatment plants having laboratories far larger than needed for day-to-day monitoring requirements. These laboratories either stand idle or operate inefficiently; or they become competitors of independent commercial laboratories when their managers seek to exploit their unused capacity. Recently, a municipal sewage treatment plant was built at a cost of a half million dollars to perform an amount of analytical work that could be provided by a private lab, like Lancaster, for fees about equal to the interest on the investment in that facility.

Still on the subject of water testing, let me describe our experience in trying to respond to a recent Department of Agriculture solicitation. In early 1982, RFP R9-82-09 was published in the Commerce Business Daily by the USDA

Forest Services, Eastern Region. This excessively complex request for proposal concerned water testing at a large number of Forest Service locations in the Eastern U. S. One of the stated objectives of the RFP was a comparison of costs between in-house and private-sector laboratories, but the RFP was written in such a way as to favor inherently the Government's own cost figures. In addition, the RFP was not limited to profitmaking labs as shown by the fact that one of the five lowest bidders was the University of Iowa.

This last point raises the subject of commercial testing and analytical services offered by university laboratories, a particularly aggravating practice discussed at some length in my testimony at last year's Hayakawa hearings. University competition is on the increase, unfortunately, because educational funds are tight and because popular wisdom is touting "industry-university cooperation" as the solution to the United States' technological malaise. We cannot but sympathize with the financial plight of institutions of higher learning, and we favor help to them from industry and other private-sector sources. However, ACIL is convinced that the proper roles of universities remain education and basic research. Whatever their needs and pressures, the more universities stray into the paths of applied research and commercial activity, so much do they compromise their calling, shortchange their students, and debase that unrestricted pursuit of truth which is the coin of the realm of academe. In the process, they do substantial harm to profitmaking small businesses.

Here are a few recent illustrations of this lamentable phenomenon:

The University of Utah Research Institute operates a division called UBTL which offers a full line of anlytical testing related to industrial hygiene. These services are offered to both industry and Government agencies. In its advertising, UBTL boasts of having performed over 110,000 analyses for the National Institute for Occupational Health (NIOSH) and having performed "extensive analytical work" for the Occupational Safety and Health Administration (OSHA). Its brochure, mailed to prospective industrial clients, states that "Order forms, fee schedules, prepared sampling devices and mailers are available upon request." Thus, we have a tax-favored, non-profit university competing in the private sector and being encouraged to do so by two Government agencies.

Not long ago, Carnegie-Mellon Institute purchased outright a private laboratory (Materials Consultants Laboratories), thereby turning a potential tax revenue source into a tax-supported entity. The facility now becomes a drain on the Federal and State treasuries, either directly through subsidies for things like scientific equipment, or indirectly, by special privileges accorded non-profits (e.g., non-profit mailing status).

Within the past year I was contracted by the chairman of the chemistry department of a local college. He was planning to request funds from the National Science Foundation for a sophisticated analytical device and was surveying the local business community to determine its interest in purchasing time on the instrument. He told me he was hoping thereby both to defray overhead and to make his proposal more attractive to NSF by including the promise of industry-university cooperation. Needless to say, I expressed no interest in participating in such an arrangement and questioned its propriety.

The USDA's agricultural extension service is an example of a more mature program in which good intentions have gone awry. All states have an agriculture extension service as part of their State University system. Their original purpose was to provide a centralized system of support to our nation's farmers at a time when we had principally an agrarian society. As industrialization has spread, so too has the USDA extension service, which now offers services such as lawn and soil testing, pesticide residue analysis for consumers, and sludge analysis for municipalities and industries. These services are not inherently governmental or consistent with the educational goals of the university of which they are a part; and they have put many profitmaking firms out of business. Once a laboratory like the Merkle Lab at Pennsylvania State University is established to offer pesticide analysis, it is almost impossible to dismantle. It operates like a business with the added advantages of tax subsidies for equipment, property, and the like, and it does not contribute to the tax base as would a profitmaking firm.

The several thousand independent research and testing laboratories are but one sector of the diverse U. S. business and industrial complex that is adversely affected by government competition, both direct and indirect. There are hundreds of thousands of profitmaking firms, especially small businesses, whose prospects for growth, at times even for continued viability, are jeopardized by government competition in some shape or form. For this reason, we welcome the Economy in Government Act of 1982.

S. 2278 is by no means the first attempt to advance the policy of government reliance on the private sector. As already noted, Senator Hayakawa and Representative Drier took the commendable step last year of introducing a joint resolution to promote this policy. Further, the Office of Management and Budget, through its Circular A-76, has been advocating reliance on the private sector since the 1950's. However, the legislation introduced by Senator East is considerably more ambitious than either of these; it embodies two extremely progressive features that deserve special attention.

The first distinguishing characteristic of the Economy in Government Act of 1982 is its requirement that the government procure its goods and services from profitmaking business concerns. The narrowing of "private sector" to the commercial, tax-paying segment of non-government corrects a critical deficiency both in OMB Circular A-76 and in the Hayakawa-Drier Resolution. Because universities and non-profit organizations are a part of the private sector, merely to mandate government reliance on that sector is not to solve radically the problem of government competition. The importance of the distinction between the two expressions magnifies each year, as nonprofit institutions and organizations expand further into the commercial sphere.

The incidence of nonprofits in the marketplace has worsened considerably in the past 30 years, but even in the 1950's it was recognized by Congress as a problem. At that time, Congress sought to use the tools at its disposal, the Federal income tax exemption for charitable, educational and scientific research organizations, to deal with the problem on a national scale. The "unrelated business income" tax provisions of the Revenue Act of 1950 and the Tax Reform Act of 1969 were fundamentally intended to reduce "the unfair competition which exists when a tax-exempt organization engages in competition with tax-paying business," (96 Cong. Rec. 13273 (1950) remarks of Senator George).

The legislative history of these Acts reflects concern about the economic leverage tax exemption provides, as well as the serious problem of nonprofit organizations diverting their interest, attention, and funds from their proper functions of carrying on charitable, educational, or other activities. In 1950, Congress provided for the taxation of "unrelated business income" of nonprofit corporations because of the growing "unfair competition" with for-profit companies, particularly citing the use of future tax-free earnings to expand operations. (H.R. Rept. No. 2319, 81st Cong., 2d Sess. 36 (1950); S. Rept. No. 2375, 81st Cong., 2d Sess. 28-29 (1950).) At that time research and development for Federal and State governments was excluded from taxation because such activities were not ordinarily undertaken for profit. In 1969, the unrelated business income provision was expanded for the same reason, continued unfair competition by nonprofit corporations. (H.R. Rept. No. 91-413, 91st Cong., 1st Sess. 44 (1969); S. Rept. No. 91-552, 91st Cong., 1st Sess. 67-71 (1969).) The House Committee on Ways and Means and the Senate Finance Committee also concluded that a serious problem stemmed from managers of nonprofit organizations becoming "so interested in making a success of the business, or in meeting competition that most of their attention and interest is devoted to this with the result that what is supposed to be their function, that of carrying on charitable, educational, etc. activities is neglected." (S. Rept. No. 91-552, supra at 39; H.R. Rept. No. 91-413, supra at 27.)

These legislative efforts to deal with the problem have not been adequate. More than a decade has passed and the problem has become even more severe. One example of the loopholes under the current law is the fact that a non-profit organization's income from any research and development activities for a governmental unit is not subject to Federal income tax. Income generated by universities performing research of any nature, whether or not performed for private clients in competition with private laboratories, is exempt from the Federal income tax.

Every time a nonprofit entity provides a good or service that might have been provided by a profitmaking business, the U. S. public is a double loser. In the short run, it loses the tax revenues that should properly derive from such commercial activity. In the long run, the public suffers because the multiplication of instances of commercial activity by nonprofits weakens the base of free-enterprise, tax-paying business, which is the bedrock on which this nation's economic health depends.

Because of its emphasis on profitmaking businesses, the title of S. 2278 is more than a hollow claim. Its provisions are a clear and definite charter for greater economy in government.

The second feature of the Economy in Government Act of 1982 to which ACIL directs special attention is Sec. 4 (b) (1):

> It is further the policy of the Federal Government that, except as provided in paragraph (2), no State or political subdivision thereof use Federal financial assistance to start or conduct any commercial or industrial activity in the government of the State or political subdivision thereof to provide goods or services for the use of or on behalf of the State or political subdivision if the goods or services can be procured from any responsive and responsible profitmaking business concern at fair and reasonable prices.

In this age of Federalism, with the shifting of responsibility for many programs to the states, this section of S. 2278 is crucial and represents a dramatic advance over previous initiatives to reduce government competition and enhance government economy.

In conclusion, let me commend Senators East and Hayakawa for introducing the Economy in Government Act, and Senator Danforth and the members of his Subcommittee on Federal Expenditures, Research and Rules for holding these hearings. I hope that my presentation of the perspective of the American Council of Independent Laboratories on the issue of government competition will prove helpful. And I thank you, Senator Danforth, for affording me an opportunity to present these views.

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GOVERNMENT COMPETITION: *A Threat to Small Business*

March, 1980

REPORT of the SBA Advocacy Task Group on Government Competition with Small Business

Office of the Chief Counsel for Advocacy
Office of Interagency Policy

U.S. Small Business Administration

FOREWORD

It is more than one hundred years since Mr. Justice Miller said for the Supreme Court of the United States:

> The theory of our governments, state and national, is opposed to the deposit of unlimited power anywhere.

There is even in our time of gargantuan Government and Government-sized business, still no "unlimited power" anywhere in our country. Our system of legal and regulatory checks and balances, our elective process, our Government of laws and not of men, have served us remarkably well in that regard. What undergirds all of those safeguards, however, is citizen vigilance--citizen vigilance in defense of "the theory of our Government."

Citizen vigilance means timely sensitivity to the need for new limitations on power, whether public or private, which threatens to go out of bounds. Timeliness is obviously a critical requirement in controlling the growth of power before it gets anywhere near the point of being "unlimited."

This Report is an expression of the timely citizen vigilance of a group of small business people concerned with the need to control the Federal Government's power to expand its own role in the economy. Their central concern is the use Government has made of its authority to create tax-supported instrumentalities which engage in direct economic competition with small, private, for-profit enterprises.

President Carter has already taken several steps to increase the ability of the Executive Branch of the Federal Government to control itself in this area. He has ordered the use of new and promising mechanisms to make the basic self-control machinery created by direction of President Eisenhower far more effective than it has yet been.

This Task Group was named by me after extended discussions with many small business leaders and trade association executives. Those who served on it were selected because of their experience and standing within their own industries as representative opinion leaders. This Report and its recommendations are entirely their product. The staff of the Office of Advocacy has assisted them in the management of the hearing process, in the assembly of information and in the ministerial conduct of their affairs. My colleague, SBA Administrator A. Vernon Weaver, approved the hearings which I conducted for the Task Group pursuant to P.L. 94-305. But the recommendations and the justifications given for them are entirely those of the Task Group.

Dale Nelson of Des Moines, Iowa, Chairman of the Task Group, has been particularly generous with his time and efforts. He is a classic American small business entrepreneur and conducted the affairs of the Task Group with the vigor, grace and dedication typical of the best of small business.

Whatever support or opposition the views of this citizen group commands, two things about the Task Group are noteworthy First, until now, concern about Government competition has been limited almost entirely to leaders and organizations of larger business. This is the first extensive review of the subject by a group of concerned small business people, bringing to the subject their special experiences and points-of-view. Second, this Report is one of many contributions which small business needs to make to a balanced discussion of "power and its limitations" as it applies both to Government and to Government-sized business.

Small business is potentially one of the Nation's most effective guardians of its economic diversity and political liberty. Small business persons, even in concert, offer no conceivable threat to their fellow citizens of ever having "unlimited power." This is not because they are better as people than those who manage Government or Government-sized business. It is merely because they are by definition individually "small" both in the marketplace of goods and services and in the marketplace of clout. The larger their share of the economy, therefore, the more reasonable it is to assume the citizenry will be safer from the misuse of power either by Government or by Government-sized business. In that sense every citizen has a stake in having the small business sector become as strong as possible relative both to Government and to Government-sized business.

Small business will surely be called upon often in the years ahead to provide opinion leadership in discussions of the need for limiting the power of both Government and Government-sized business. The members of this Task Group deserve the thanks of all of us for a noteworthy initial contribution.

Milton D Stewart

Milton D. Stewart
Chief Counsel for Advocacy

DIGEST

BACKGROUND

"Government competition" with small business is a complex and controversial subject whose practical effects are much easier to understand than its many conceptual facets. Perhaps the greatest difficulty in analyzing and reporting this phenomenon has been to adequately develop and relate most of the aspects of what initially appeared to be such an obvious and simple matter.

Economic statistics consistently document the substantial contribution small business makes to the economy. Accordingly, small business owners are justifiably concerned with Government's growing intrusions into the marketplace and its frequent lack of appreciation for the differences between small and large businesses, taxpaying organizations and non-profit organizations. To the small business community, the issue of "Government competition" represents a serious threat to those already experiencing economic difficulty from other Governmental policies and other economic forces. No clearer indication of the need for action can be found than the allegations and experiences of small business people whose unpleasant encounters with Government competition were presented to the Task Group and U.S. Small Business Administration. The two examples that follow illustrate how a successful entrepreneur's business can be crippled or threatened with extinction by a Government agency's decision to produce goods or services currently provided by the private sector.

Imagine yourself as the president and owner of a small, successful high-technology firm providing precision testing services on solar collectors. You have produced state-of-the-art techniques, invested heavily in sophisticated testing instruments, and constructed new facilities to handle the growing demand. You have hired many new, highly-skilled employees whom you have also trained. You are known worldwide as a leading and highly reliable business which consistently maintains rigorous standards and provides only the highest quality work.

You have private competitors, but their business and yours begin to drop precipitously as the result of Governmental actions occurring at several different levels. One Federal agency underwrites competitive testing services by funding non-profit universities whose subsidization enables them to beat your prices. You pay the taxes; they get the business. Another Federal agency undermines your reputation by treating you and your competition--private or otherwise--equally, by granting the same _de facto_ accreditation to all, despite your proven superiority. _Lastly_, an agency created by the state in which you do most of your business, not only prohibits you from servicing your customers in that state but establishes its own monopoly in the state by doing all such testing for itself. In addition, it enters into direct competition with you by offering its testing services on an interstate basis.

Or, imagine yourself as one of many small businesses in the metropolitan courier industry. For many years, you have been providing needed, rapid-delivery services. Unexpectedly, the United States Postal Service decides to establish a local, same-day, small package delivery service. Postal studies indicate that the service will eventually compete directly with you in a substantial way even though the Postal Service maintains that this is not the primary aim of the new service. There is considerable evidence that the new service is inefficient and superfluous. Based on Postal Service documents, the Office of Advocacy determines that the advertising costs for the service will total $1 million in its first year of operation while yielding a mere $250,000 in revenues! Nevertheless, the Postal Service expects to implement the program nationwide, inevitably competing with your business and many others.

Neither case is imaginary. Both dramatically illustrate the plight of small business owners who suffer from Government competition. Viewed from this perspective, the issue is indeed relatively simple, and the solution seems obvious: "Get the Government out of business." Government should not compete with private enterprise, but, if it does, the competition should at least be fair where it enters the marketplace.

Essentially, this is the perspective that motivated numerous small business people to express their concerns about "Government competition" to the Office of Advocacy and to the Chief Counsel for Advocacy in particular. Their lament was widespread and genuine. Often their accounts were vivid and touching stories expressed more in the terms of the taxpayer outraged by Government waste and stupidity rather than in terms of the business person threatened by Government economic activity.

FORMATION OF THE TASK GROUP

The Chief Counsel's paramount responsibilities under P.L. 94-305, which established his Office, include recommending "specific measures for creating an environment in which all business will have the opportunity to compete effectively and expand to their full potential...." Hence, the frequency and substance of the complaints about "Government competition" prompted the Chief Counsel to create a small business Task Group on Government Competition. While he recognized the issues as complex, he was also acutely aware of the fact that Government competition per se had never really been subjected to public scrutiny; and, certainly, small business never had been given much opportunity to express its concerns or to effect public policies in this area.

Elsewhere, events were occurring that heightened the need for some action by the small business community. Several studies of the Federal procurement process were issued, Congressional hearings on Federal contracting policies were initiated,* legislation reauthorizing the Office of Federal Procurement Policy (OFPP) in the Office of Management and Budget (OMB) was under Congressional scrutiny, and important revisions to OMB Circular A-76 (the primary directive affecting Government procurement and production of goods and services) were implemented by OFPP.

To ensure that small business had ample opportunity to document instances of Government competition at all levels and to express its views on the issue, the Chief Counsel appointed numerous small business owners to the Task Group. Several had actually experienced direct or indirect competition from Government at the Federal, state or local level.

The Task Group collected information through public hearings, research, and working sessions held by subcommittees assigned the following specific tasks:

- Subcommittee No. 1 - Analyze the scope and content of Revised Circular A-76 and determine the small business impact;
- Subcommittee No. 2 - Analyze the provisions for administration and implementation of Revised Circular A-76 and determine the small business impact;
- Subcommittee No. 3 - Assess the incidence and effects of direct competition with small business by Federal, state and local Governments; and
- Subcommittee No. 4 - Assess the incidence and effects of indirect competition with small business by Federal, state and local Governments.

FINDINGS

"Government competition" means different things to different people. There is no commonly accepted definition. What concerns small business and the Task Group is any instance where a Governmental unit provides for itself (or for others) goods or services that the private sector--i.e., for-profit enterprise can produce. OMB labels these activities as "commercial/industrial" (c/i) and defines them as any activity that "is operated and managed by a Federal agency and which provides a service or product that could be obtained from a private source." To the Task Group's great disappointment, "private source" within the OMB definition provided in Revised Circular A-76 includes any "non-Federal" source. As a result, non-profit entities such as sheltered workshops and state universities are not distinguished from for-profit businesses in OMB's enforcement of the Revised Circular.

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*For example, H.R. 4717, a bill to stop waste in contracting, introduced by Congressman Herbert E. Harris, II (D.Va.) has been reported favorably by the House Committee on Post Office and Civil Service. Some provisions have been referred to the House Committee on Government Operations.

Additional lack of specificity stems from the different terms used in referring to Government competition issues. In some circles, it is a matter of "make-or-buy"; in others, it is "contracting-out" versus performing the activity "in-house"; and in others, it is "intramural" versus "extramural" activity. The true significance of this lack of specificity lies in the latitude, intended or otherwise, that contending interests extract from these amorphous terms in their respective efforts to influence or thwart A-76 type policies.

Private sector interest groups were found to include employees, taxpayers, large and small businesses, non-profits and grantees, and organizations representing these interests. In the public sector, there are state and local Government interests. At the Federal level, one encounters the interests of the Executive Branch (agencies, the White House, OMB and OFPP), those of Congress (committees, legislators and their constituents, the General Accounting Office), and those of Federal employees and their unions.

Full consideration of the competition issue required the recognition of these interests. It also required recognition of the fact that Congress has never enacted uniform policies to govern Federal "c/i" activities generally. Instead, myriad statutes (estimates run as high as 4,000) have been enacted that govern different aspects of procurement, whether in pursuit of some conscious, overriding preference for social goals or inadvertently as the result of some other legislative pursuit.

In addition, the Task Group found that there is no consistent Executive policy governing and strictly enforcing Federal Government reliance on the private sector. Unfortunately, what began in the 1950's as an effort to protect against Government competition has gradually eroded to a point where there is no longer a preference for truly private enterprise. Specifically, the Bureau of the Budget Bulletin No. 55-4 (1955) stated that "the Federal Government will not start or carry on any commercial activity to provide a service for its own use if such product or service can be procured from private enterprise through ordinary business." The present doctrine, OMB Revised Circular A-76, merely expresses a preference for "non-Federal" rather than Federal sources while OMB conducts yet another "inventory" of "c/i" activities. In other words, there has been a definite shift away from reliance on the traditional private sector to a new policy of supposedly choosing the most "economical" alternative, whether it is private, Governmental, or some point in between (i.e., non-profits).

Today's priority is ostensibly "economy" and "savings" to the taxpayer. Yet earlier reports such as that of the 1972 Commission on Government Procurement and more recent ones, such as that of the Office of Federal Procurement Policy (OFPP), unanimously confirm the principle that true competition produces the greatest savings. In 1972, the Procurement Commission recommended creation of a Federal agency to ensure maximum feasible efficiency in Federal procurement. In response, Congress created the OFPP in 1975. Surprisingly, however, the preference for private enterprise that already existed within the Executive Branch in 1972 disappeared under OFPP's direction (as discussed later) despite the Commission's commitment to that principle and its accordant recommendation that Congress, by statute or resolution, establish the preference for private enterprise as a national priority. Obviously, some important expectations based on historical developments have not been met.

The Task Group eventually catalogued an impressive array of instances of direct and indirect competition, and it discovered that state and local Governments (frequently in disbursing Federal grants-in-aid) are as guilty of contributing to the problem as are Federal agencies. Government competition was found in such areas as retailing, printing, manufacturing, employment services, travel services, distribution, communications, wholesaling, warehousing, audio-visual aids, research and development, laboratory testing services, day-care centers, and a host of other activities. The extent of Government "c/i" activities is astounding.

While admittedly conservative estimates reveal the impact of the competition issue on small business, it is the taxpayer who must pay for the Government's "c/i" activities and compensate for the tax revenues that are lost when these activities are not performed by the private sector. These data indicate that, at a minimum, Federal in-house "c/i" activities in 1977 numbered 21,130 at an annual operating cost of nearly $10 billion.** Another $30 billion is contracted-out. The best estimate is that at least $2 billion annually might flow directly to small business if that $10 billion were contracted-out in approximately the same proportion as other activities

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**The actual figure was a VERY CONSERVATIVE $9.5 billion and did not include "c/i" activities involving training, medical services, or research and development.

that are presently contracted-out. This amount would increase dramatically if Revised A-76 were extended to include competition for the estimated $100 billion annually in state and local programs funded (but now shielded from private competition) by Federal grants.

Concentrating on the figure of $10 billion for current in-house activities, the Task Group was also able to estimate the potential savings to the taxpayer if the 85 percent of those in-house activities that are presently justified in non-cost terms were opened up to competition. Most authorities estimate that competition will lead to an average savings of 35 percent over non-competitive costs. Using this factor and assuming there would be competition for all Federal "c/i" activities, the average annual savings to the taxpayer would be (.35 X .85 X $10 billion=) $2.98 billion! Clearly, small business is not the only likely beneficiary if Federal in-house "c/i" activities can be reduced.

Despite intensified efforts by small business advocates, the average annual increase in total Federal contract dollars awarded to small business over the last ten years has remained at approximately one percent and the total small business share represents a mere one-fifth of the amounts spent. On the other hand, there has been a dramatic increase in the number of groups competing for this small business share. Minority-owned businesses, labor surplus firms, women, handicapped and veterans have entered the field as eligible small businesses, rightfully demanding an equitable share of Federal contract dollars. These demands have divided the small percentage of dollars available to all small businesses already in the Federal marketplace and have taken place with no appreciable increase in the Federal procurement dollars available to the entire small business sector.

If all this were not enough to reveal the complexity or potential for conflict inherent in the "competition" issue, there is the matter of understanding "competition" in terms of the Federal system. The Federal system not only imposes several layers of Government to consider in terms of "competitive" programs but also, in the opinion of the Task Group, raises the issue of adopting parallel "c/i" rules at the state and local levels.

The Task Group found that, while Federal policies are presently in disarray, state and local policies are nearly nonexistent. As a result, a great deal more was determined about the nature and extent of "Government competition" at the Federal level. All available information indicates that the rate of expenditures on in-house activities by state and local Governments may be as high as it is at the Federal level. At the state and local levels, however, there may be more opportunities for savings to the taxpayer than at the Federal level.

CONCLUSIONS

The Task Group concluded early in its assessment that the issues underlying "Government competition" are occasionally nebulous and frequently quite complex, that the interests involved are strong and diverse, and that several important opportunities for small business to influence policy-making have already passed.

It is with a feeling of disappointment and alarm that we report that the preference for the private sector, which is so consistent with our national history and practice, has suffered so much decline for no satisfactory reason. We are alarmed that the same forces that created this decline may have achieved so much momentum, as evidenced by recent Congressional activities, that further erosion is yet to come. To stem any further erosion, it is important that Congress mandate by statute or resolution the preference for the private sector as national policy.

While commendable in the abstract, the new preference for "economy" found in OMB's Revised Circular A-76 not only sacrifices the previous preference for private enterprise but also, at some sacrifice in savings, acknowledges the continued existence of many Federal "c/i" activities now in force. We were disappointed to learn that as a result of OMB's past, poor performance in this area, so little specific information is available about Federal "c/i" activities. As demonstrated, enforcement of A-76 would benefit not only the private sector but accrue savings to the taxpayer.

We find some encouragement, however, in OFPP's commitment to enforce Revised A-76 and conduct a more complete "inventory" of Government "c/i" activities.

RECOMMENDATIONS

The Task Group recommends that:

- the preference for private (for-profit) enterprise be reinstated in Revised A-76;
- Congress enact legislation specifically mandating this preference;
- Federal policies consistently recognize and provide for the special problems of small business, in addition to asserting a preference for the private sector;
- the preference for private enterprise and any accompanying provisions favorable to small business be extended to cover all Federal monies committed to state and local Governments;

- wherever possible, Governmental agencies which continue to perform commercial/industrial activities that compete with private enterprise not regulate the private concerns with which they compete;
- where Federal agencies perform any commercial/industrial activity, the Office of Management and Budget conduct regular reviews to ensure maximum cost efficiency and to determine whether the activity can be contracted-out;
- the Internal Revenue Code and its accompanying regulations be amended to more clearly distinguish between for-profits and non-profits and to narrow the scope of "related-business activity"; and
- more states adopt the policy of open competition and a preference for the private sector in meeting their needs for goods and services.***

The Task Group made many other recommendations which appear in Chapter V of this Report. The basis for each recommendation is developed in the main text.

***For basic information, _see_ two recent publications by the Office of the Chief Counsel for Advocacy, U.S. Small Business Administration (Washington, D.C.): _The Directory of State Small Business Programs_, 1979 ed. (May, 1979); and _The States and Small Business: Report on the First National Conference on State Small Business Programs_ (May, 1979).

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Senator **Danforth**. Mr. Cooper, you are our next witness.

TESTIMONY OF BENJAMIN Y. COOPER, VICE PRESIDENT OF GOVERNMENT AFFAIRS, PRINTING INDUSTRIES OF AMERICA, INC.

Mr. **Cooper**. Thank you, Mr. Chairman. I appreciate the opportunity to present the views of the Printing Industries of America this morning.

We are here in somewhat of a unique role and because, unlike the previous witnesses and most others in the Federal Government, we are currently not subject to A-76. In addition to that, the contracting and the competition that we experience are not with the executive branch but with the legislative branch.

The Government printing system is handled through the Government Printing Office, which is a legislative branch agency. The Government printshops are established and the printing equipment authorized by the Joint Committee on Printing.

So our situation is unique. We also have a unique situation in that the work that is handled by the Government Printing Office is handled, we believe, in the most effective and efficient manner of any agency of the Federal Government.

In the past year, 72 percent of what the GPO handled was procured commercially. In excess of 80 percent of that procurement was awarded to small business, so that procurement system is very effective, and it is a situation that we promote and continue to encourage.

Our problem in the ongoing battle is with the additional printing facilities. The Federal Government, in addition to the Government Printing Office, operates some 350 Federal printing facilities ranging from small duplicating shops to full-fledged printshops. These facilities, as I indicated, authorized by the Joint Committee on Printing, many of which were authorized years ago, have continued to operate.

We frankly would like to see a system that would blend all of those facilities into the Government Printing Office operation where we believe the procurement system is operated fairly and to the benefit of the taxpayer, the printing industry, and the Federal Government.

The problem we have with the Federal agencies, in addition, is that their cost accounting methods bear no reflection to reality. I have included in my statement a copy of JCP Form No. 1, which is the form used by agency shops to compute their in-house costs.

The example that I've given shows that the allowance for space occupied by Federal printing facilities is 14.5 cents per month. The form that I've provided is for a printshop located on Third Avenue in Brooklyn, N.Y. I doubt seriously that any facility could be acquired there at 14.5 cents a square foot. In addition to that, the salary costs are computed only on the basis of salaries and sick leave and annual leave. No other benefits are folded into that. So when you get a per unit cost, it is severely skewed by those low estimates.

The East bill and the Hayakawa resolution are certainly effective for us because they do provide a direction for the Government. Frankly, what we would like to see is the Federal printing plants covered by A-76, which would give them more incentive to look to the private sector. We would also like to see an increased reliance on the Government Printing Office and their procurement system.

I might also point out that while we do have our problems with the Government Printing Office in procurement matters their system is so good, particularly for small business, that it might bear some studying by the committee to see how effective it is.

There are some 8,000 printers involved in the printing procurement system. Nearly 3,000 of those are actually awarded contracts on an annual basis, and the average contract usually is around $2,000. It's a very effective system for small business. If we could just get the whole Federal system folded in, I think we would be satisfied.

Thank you very much. I'd be happy to answer any questions.

Senator **Danforth**. Thank you. Without objection, your statement will be made a part of the record.

[Mr. Cooper's prepared statement follows:]

PRINTING INDUSTRIES OF AMERICA, INC.

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Government Affairs
Department

TESTIMONY OF

THE PRINTING INDUSTRIES OF AMERICA

AND

THE NATIONAL ASSOCIATION OF PRINTERS AND LITHOGRAPHERS

BEFORE THE

SUBCOMMITTEE ON FEDERAL EXPENDITURES, RESEARCH AND RULES

OF THE

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

ON

FEDERAL GOVERNMENT COMPETITION WITH PRIVATE INDUSTRY

MAY 18, 1982

For Additional Information Contact:

Benjamin Y. Cooper
Vice President
Government Affairs

Mr. Chairman and members of the Committee, my name is Benjamin Y. Cooper. I am Vice President of Government Affairs for the Printing Industries of America. PIA is the nation's largest graphic arts trade association with over 10,000 members nationwide. The member companies of PIA comprise over 75 percent of the sales of the graphic arts industry. My testimony today is also presented in behalf of the 2,500 members of the National Association of Printers and Lithographers.

For the purposes of this hearing, it is important to note that printing is the nation's seventh largest manufacturing industry. The value of shipments in the industry will exceed $70 billion this year. Despite this standing, printing is essentially an industry of small business. Approximately 80 percent of the companies in the industry have 20 or fewer employees.

Our concern with government competition is unique in these proceedings since our major source of government contracts is a legislative branch agency - the Government Printing Office. Further, the body which determines the extent of competition the industry experiences with the government is a committee of Congress - the Joint Committee on Printing. The Government Printing Office serves as the printer for the Congress and to a lesser extent the executive branch agencies and it serves as the printing procurement agent for the entire federal government. The Joint Committee on Printing, in effect, serves as a Board of Directors for the GPO, providing rules of operation and also has the authority to authorize federal printing plants and the purchase of printing equipment for federal agencies.

In recent years, the GPO has grown to a printing and publishing operation exceeding $1 billion. Printing represents $600 to $650 million of that total with approximately 70 percent or $420 to $450 million procured in the commercial market. The remaining $200 million is Congressional printing, the Federal Register and other work which is retained inside the GPO to assure maximum efficient utilization of equipment. Although the printing industry has never been content with the federal government's operation of the world's largest print shop, the industry has been reasonably satisfied with the professionalism and fairness of the GPO procurement system.

The GPO has consistently maintained a strong commitment to contracting out and to contracting out to small business. In fiscal year 1981, 72 percent of the printing work handled by the GPO was procured from the commercial sector. Over 80 percent of that amount was awarded to small business printing companies. The GPO maintains a rotating bid list and a regional procurement system which enables over 8,000 companies to compete for government printing contracts. Approximately 2,700 companies are ultimately awarded contracts with the typical contract often under $2,000. We believe this system assures the delivery of the best product at the lowest possible price. The relationship between the industry and the GPO has remained strong with the mutual interests of providing the best product, at the lowest price, and in the most equitable manner pursued vigorously. In our experience dealing with the GPO, there have been only rare occasions when solutions to contracting problems have not been resolved to the complete satisfaction of the industry. Without belaboring the point, we believe the GPO is the best procurer of services in the federal government. The strength of that procurement system, however, does not alter the fact that the federal government is deeply entrenched in the manufacture of printed products in direct competition with private enterprise.

While the procurement system at the GPO is equitable, the cost of having work printed at the GPO provides testimony to the need for additional contracting out. The following table illustrates the differences in wages paid GPO employees and union negotiated contract wages in Washington, D. C.:

	GPO (1982)	Washington, D. C. (1982)
Compositors	$14.35	$11.91
Bookbinders	$14.11	$13.17
Offset Strippers	$14.84	$12.70
Offset Pressmen	$14.84	$12.06 (IPGCU contract)

Note that GPO employees earn their higher hourly wages over a 40 hour week while private industry employees work 35 hour weeks. In addition to these wages, GPO employees who work the night shift, at which time the *Congressional Record* is printed, receive a 15 percent differential as compared to a 5 to 10 percent differential for private sector employees. From our determinations, employees at the GPO are the most highly compensated printing employees in the country. Consequently, the government is paying a premium to have work printed at the GPO. In order to accomodate the Congressional schedule, a complement of competent craftsmen is maintained on a full time basis. It would be inefficient and perhaps impossible to have employees available for work on the *Congressional Record* only when the *Record* is being printed. For efficiency, these employees and the equipment at the GPO are utilized for other federal printing work.

If, for example, the Commerce Department sends a print order to the GPO, the GPO would determine whether the work should be commercially procured or whether the work should be retained for printing within the GPO. If the work fits the equipment at the GPO and the Congressional demands are low, the work is retained in-house. This system has generally worked to the mutual benefit of the public and private sector, since more than 2/3 of the GPO volume has been procured.

Unfortunately, the federal printing story does not end with the GPO because in addition to the GPO, the federal government maintains some 350 additional printing operations. These facilities range from small duplicating facilities to major printing enterprises. With the rare exception of a top secret printing requirement, all the work handled in these facilities could be procured from private sources.

The examples of flagrant competition by these additional shops are almost endless. Printing is the Washington Metropolitan area's largest manufacturing enterprise. Yet, the federal government finds it necessary to maintain 60 printing plants. In New York City, the GPO field facility is literally surrounded by printing companies. In addition to the GPO facility in New York, the federal government operates seven other facilities.

The situation for the printing industry is particularly frustrating because virtually every inquiry into the area of government printing has pointed to the waste and duplication associated with these facilities and the fact that work procured was cheaper than work done in-house. Why then are we in this situation?

Printing should be a particular thorn in the side of Congress because as pointed out earlier federal government printing is essentially a legislative branch enterprise. The GPO is a legislative branch agency. Policies at the GPO and the authorization of printing facilities for the entire federal government (with some statutory exceptions) are the responsibility of the Joint Committee on Printing. Consequently, while we may fault the agency for requesting the equipment to establish a printing facility, the approval is given on a case-by-case basis by the JCP. To its credit, the current JCP is considerably more aggressive in its review of federal printing facilities and has in fact refused to reauthorize a number of plants in the past year. Unfortunately, the current activity is too late and too slow. Frankly, we want the Federal Government - both the legislative and executive branch - to stop doing work that can be done more efficiently and at a lower cost by the private sector.

Evidence of our frustration is a study currently under way by the JCP regarding the eight federal printing facilities in New York. These facilities are located in the world's largest printing center. We have proposed to the JCP that the New York City study presents a perfect opportunity to investigate an "all procurement" option. Through a GPO purchasing agent, all the printing requirements of federal agencies in New York could be procured. Recognizing the potential sensitivity to employees who might be displaced by the switch to "all procurement," PIA has offered the employee referral service of the Printing Industries of Metropolitan New York and the Printing Industry of Connecticut to assist in the placement of then employees. From our standpoint, there should be no question that the New York facilities would be closed.

Our problem is that federal printing is on a seemingly endless cycle of growth. First, a small duplicating facility is set up to do "quick and dirty" work. The equipment is replaced by more sophisticated equipment and more sophisticated employees are hired to operate it. The increased capacity increases the demands on the equipment so more equipment is requested. The next step is higher technology such as sophisticated phototypesetting equipment. Rapid technological change in the printing industry also tends to promote more in-house activity as federal agencies investigate and seek approval for the purchase of new equipment capable of producing commercial quality work. Each purchase takes more work out of the commercial sector, but worst of all, such purchases freeze technology for that agency. If the agency bought the services commercially, it could seek out the most advanced contractor. Subsequent contracts could advance to higher technological formats. Buying the equipment, however, means the agency will remain wedded to that technology until new equipment can be purchased.

The problems seem endless. As an industry organization, we spend considerable time in the watchdog role making sure the JCP has not authorized unnecessary equipment at one agency or another, or that wage negotiations at the GPO do not force private sector employees to push for higher wages to "catch up" with the government, or to make sure the GPO procurement system remains fair. We would prefer that the Congress bring a halt to the competition, particularly in an area directly under its control.

We believe legislation such as S. 2278 sponsored by Senator East is a good, strong step forward; however, the federal government, at all levels, must commit to contracting out in order for the legislation to be effective. In addition to Senator East's legislation, we would propose that OMB management directive A-76 be made law. Printing is currently exempt from coverage so legislation would be necessary to apply the directive to the GPO and all federal printing. Further, acceptable costing standards for the federal government must be established to assure equitable public and private cost comparisons. As an example of such a problem, I have enclosed a copy of JCP Form 1. Fortunately, this form is being revised but it is currently in use. Please note facility and overhead costs are calculated at an unrealistic 14.5¢ per square foot. The facility in question on this form is in New York City. Further, the employee costs includes no benefits. We would also urge Congress to determine the level of printing to be performed by the GPO and restrict printing to that level. Other agencies'printshops should be allowed to operate only when the work performed in these shops cannot be procured or when matters of national security require in-house production.

This issue has continued with little change for years. We urge you to help end this competition as soon as possible.

JCP [illegible] NO. 1 (REV. [illegible])

Department [illegible] shall submit two copies of this report to the Joint Committee on Printing within 30 days after the close of each of the first three fiscal quarters. The fiscal [illegible] report shall be forwarded to the committee in duplicate not later than August 31.

DEPARTMENT OR AGENCY	NAME AND LOCATION OF PLANT (STATE, CITY, AND STREET)	JCP AUTHORIZATION NO.	FOR PERIOD ENDED
Navy Publications & Printing Service Detachment Office,	830 Third Avenue Brooklyn, New York 11232		30 Sep 81

PART I.—COST INFORMATION (FOR FISCAL YEAR ONLY)

ITEM	ALL PRINTING EXCEPT COMPOSITION [1] (COL. A)	COMPOSITION ALL TYPES [2] (COL. B)	OPERATIONS OTHER THAN PRINTING [3] (COL. C)
	Omit cents	Omit cents	Omit cents
Total salaries of all personnel including supervisory directly engaged in the operation of plant (including overtime and annual and sick leave)	$ 457796	$ 1271	$ 23198
Cost of paper, ink, chemicals, negatives, plates, etc., used during report period	244292	----	966
Depreciation of equipment (1% per month of original cost until fully depreciated)	28631	91	1704
Amount spent for repairs and maintenance	37446	7	1605
Allowance for space occupied (whether Government owned or rented), utilities, etc. (14.5 cents per month per square foot of total space occupied)	56290	179	3350
Amount spent for rental of equipment	52709	---	32590
Total cost (Use col. A total from this line to compute cost per 1,000 units)	877164	1548	63914
Total cost of printing including composition (col. A + col. B)	878712		x x x x x

[1] Include in Column A cost of all offset camera work, negative work, imposition, platemaking, duplicating, presswork, scoring, perforating, numbering, folding, collating, gathering, drilling, punching, stitching, sewing, inserting, tipping, padding, trimming, tying, wrapping, and all other operations necessary to complete printing or binding product.

[2] Include in Column B cost of all composition produced by plant.

[3] Include in Column C cost of all operations not involving printing (Col. A) and composition (Col. B). Costs to be included in Column C will include but not be restricted to, addressing, distribution, camera work (other than lithographic), photostating, ozalid, B/W, etc.

PART II.—PRODUCTION INFORMATION

	PRESSWORK	UNITS PER PRESS IMPRESSION (COL. D)	NUMBER OF PRESSES IN EACH CATEGORY REPORTED (COL. E)	NUMBER OF STENCILS, MASTERS, PLATES, OR FORMS (COL. F)	TOTAL UNITS PRODUCED, EXCLUDING OVERRUNS (COL. G)
OFFSET (include mimeograph and spirit)	11" x 17" or less (maximum image 10¾" x 14")	1	3	14848	1968640
	11" x 17" or less tandem (maximum image 10¾" x 14¼")	2			
	11" x 17" (image larger than 10¾" x 14¼")	2			
	14" x 20", and 15" x 18"	2			
	11" x 17" tandem (image larger than 10¾" x 14¼") used as 8½x11	2 4	1	6087	1546101
	17" x 22" and 19" x 25"	4	3**	4573	4449280
	22" x 29"	6			
	22" x 34"	8	1***	2533	9777720
	23" x 36"	8			
	23" x 36" perfecting	16			
	34" x 44"	16			
	Other (specify) 11x17 TANDEM DUPL USED AS 8½x11	2	1 *	6335	1609207
	*Mechanical difficulties, not in production 1/2 of period				
	**Operated one 17 X 22, one vacancy to be filled, one press as back up.				
	*** Predominatly short run work, decreases total productivity.				
	Total units produced by offset this fiscal quarter PERIOD	x x x	x x x x	x x x x x	19350948
LETTERPRESS	Under 10½" x 16"	1			
	Other (specify)				
	12 X 18 (surveyed) to be disposed of, not in production.	2	1		
	Total units produced by letterpress this fiscal quarter PERIOD	x x	x x x x	x x x x x	
	Total units produced in plant this fiscal quarter PERIOD	x x x	x x x x	x x x x x	19350948
	NOTE: [illegible]				1819133[illegible]
	Total units produced in plant this fiscal year	x x x	x x x x	x x x x x	37542280
	Cost per 1,000 units (total cost of printing, excluding composition, part I, col. A, divided by total production units produced in the plant. Drop last 3 digits of col. G when computing cost per 1,000 units).				$ 23.36

PREPARED BY (Signature and title)
M. L. Stewart
M. L. Stewart, Director

DATE SUBMITTED
28 October 1981

Senator DANFORTH. Mr. Hess, do you now compete with colleges and universities?

Mr. HESS. Oh, yes.

Senator DANFORTH. Do you consider them to be effective competitors of yours?

Mr. HESS. Very definitely. One of the examples that I give in my testimony is the University of Utah doing a large volume of testing work in the area of occupational safety and health and industrial hygiene, which is one of our specialties. I can show you price lists, strictly commercial, of various universities offering all kinds of services that compete directly with us and other members of the independent laboratory community.

Senator DANFORTH. And you believe that any legislation should differentiate between for-profit and not-for-profit providers of services?

Mr. HESS. I'm not an economist. I am a chemist, but there is something that doesn't sit right with me about my having to compete with someone who is protected from paying taxes because of his public service role, but then chooses to bounce across into strictly proprietary and commercial business in direct competition with me—and the Federal Government allows it. It is that simple.

Senator DANFORTH. You mean that it is subsidizing your competitor?

Mr. HESS. Right, even though there may not be a direct subsidy—and there often is, because the equipment they are using and their facilities have usually been granted by the National Science Foundation or some other Federal agency. Their equipment hasn't been bought with after-tax dollars as mine has. And then at the same time, promoting a fee schedule that simply does not take into account any kind of taxations, using all the privilege of their nonprofit mailing permits—it creates an impossible competitive situation.

Senator DANFORTH. Yes. The Federal Government does contract with colleges and universities for a variety of things—medical research, various things for the Defense Department.

Mr. HESS. We have no fault with any kind of research that is basic or fundamental or otherwise defined as that kind of research that would be of value to the public sector. I think one can make a clear differentiation between work published in scientific journals where it is available to everyone and that that is of such applied or proprietary nature that it becomes the property of the university or some cosponsoring industry. I think there is a very clear distinction there. We are not opposing Government granting money for research in industries or research at universities in the public interest. Not at all.

Senator DANFORTH. What if the Government could go to Corporation A and ask for a bid: How much would it cost to conduct such-and-such a research project? Corporation A bids $100,000. And then you go to University X and ask the same question, and they bid $50,000. What do you think we should do?

Mr. HESS. I think that if it were research in the public interest, then I would like to see it go to the university. If it were applied research or commercial testing—the type of thing that we've been talking about—I think it is inappropriate that the Government ever go to a university with a request for proposal, because it is not something that the university should be engaged in at all.

Senator **Danforth**. So you think that the test should be something other than simply dollars and cents from the Treasury?

Mr. **Hess**. We have bid against nonprofit institutions and universities on Federal procurement for research and development, and we have gone to debriefings with the procurement people, where we have not come in the low bidder. We asked whether they have taken into account the recycling of tax dollars that would be involved if we were to get the job. They told us it would be illegal if they did that.

Now, I don't think that is quite right; nevertheless, if it is research in the public interest and it serves a supporting educational function—that's not what I'm talking about here today. I am talking about strictly proprietary or commercial activities that have no place in the nonprofit sector simply by reason of the conditions for which they are granted nonprofit status.

There is something called the unrelated business income tax for nonprofits. I think if you would go through Internal Revenue and Treasury records to find out what percentage of the nonprofit corporations really engaged in commercial activities that ever bother to file an unrelated business income tax, you'd find it extremely small.

Senator **Danforth**. But is the kind of applied research that you are talking about a big matter with colleges and universities? Is that a big item that is now being done by colleges?

Mr. **Hess**. It is almost overwhelming. You have heard the buzz words, "industry, university, Government cooperation," in trying to tap the academic institution's technological expertise to get our productivity back on the right track. I am all in favor of that as long as the educational institution is performing its role of providing basic knowledge.

What we have in Pennsylvania we have all across the country presently—commercial activity under the nonprofit umbrella that is simply forcing little businesses like ours in the private taxpaying sector just out of the market.

Senator **Danforth**. You feel that this sort of applied research—that, for example, the University of Pennsylvania might conduct—could be done by your company or some other just as well?

Mr. **Hess**. I think it could be done a lot better by our company. If you look at some of the records for small for-profit businesses, as far as their productivity and innovations per dollar invested, you'd find that the Government would not only be preserving businesses like ours but it would be getting a lot more bang for the buck.

Senator **Danforth**. Is your view that you should not be competing with them for Government contracts, rather that there should be something in law that would specifically favor the for-profit?

Mr. **Hess**. I think that this is a key element of the East bill that I would emphasize. If you remember nothing else that I said this morning, it should be that the East bill goes beyond the Hayakawa-Dreier resolution in suggesting that contracting out be defined in terms of contracting out to for-profit businesses.

I guess I've got a hangup on this matter of nonprofits engaged in commercial activities because I realize as a scientist that there is something called the conservation of matter, and I know there is a certain tax dollar that has to come out. Whenever that tax base is narrowed, it goes deeper for those of us who are still in the mainstream as taxpayers. I just don't like paying taxes to subsidize my competition.

Senator DANFORTH. Gentlemen, thank you both very much. That concludes the hearing.

[Whereupon, the subcommittee stood in recess at 11:48 a.m., subject to reconvene at the call of the Chair.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

97TH CONGRESS
1ST SESSION

S. J. RES. 93

To clarify and reaffirm that it is the basic policy of the Government of the United States to rely on the competitive private enterprise system to provide needed goods and services.

IN THE SENATE OF THE UNITED STATES

JUNE 22 (legislative day, JUNE 1), 1981

Mr. HAYAKAWA (for himself, Mr. HATCH, and Mr. NICKLES) introduced the following joint resolution; which was read twice and referred to the Committee on Governmental Affairs

JOINT RESOLUTION

To clarify and reaffirm that it is the basic policy of the Government of the United States to rely on the competitive private enterprise system to provide needed goods and services.

Whereas it is the function of Government to establish Federal policies and manage Federal programs established by or pursuant to law; and

Whereas it is the function of the private enterprise system, which is the primary source of national economic strength, to provide goods and services needed in that endeavor; and

Whereas optimum efficiency, economy, and productivity can be achieved if the Government relies on competitive procurements from private enterprise for its needed goods and services; and

Whereas in a democratic free enterprise system, the Government should not compete with its citizens: Now, therefore, be it

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That it is the general policy of the Government of the United States to rely on competitive private enterprise to supply the products and services it needs whenever competitive industry prices are available. This policy shall be administered by the Director, Office of Management and Budget in coordination with the Administrator, Office of Federal Procurement Policy.

II

97TH CONGRESS
2D SESSION

S. 2278

To provide a policy of promoting public sector procurement of goods and services from profitmaking business concerns, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 24 (legislative day, FEBRUARY 22), 1982

Mr. EAST (for himself and Mr. HAYAKAWA) introduced the following bill; which was read twice and referred to the Committee on Governmental Affairs

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A BILL

To provide a policy of promoting public sector procurement of goods and services from profitmaking business concerns, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Economy in Government Act of 1982."

CONGRESSIONAL FINDINGS

SEC. 2. The Congress finds that—

(1) it is the function of Government to establish Federal policies and manage Federal programs established by or pursuant to law;

(2) there is no consistent public policy of procuring goods and services used in the public sector from profitmaking commercial and industrial business concerns, particularly small business concerns;

(3) the establishment and execution of a consistent public policy of procurement from profitmaking commercial and industrial business concerns at fair and reasonable prices will encourage competition among such business concerns;

(4) the establishment and execution of a consistent public policy of procurement from profitmaking commercial and industrial business concerns will encourage and assist such business concerns;

(5) increased competition among and development of profitmaking commercial and industrial business concerns will insure that procurement costs of goods and services used in the public sector are fair and reasonable;

(6) it is in the public interest to encourage the commercial and industrial activities of profitmaking business concerns and to discourage such activities in the public sector; and

(7) a significant increase by the Government in procuring its needs from private enterprise sources will enable the Government to reallocate a large number of Federal positions to work which must be performed by Government employees.

DEFINITIONS

SEC. 3. As used in this Act—

(1) the term "agency" has the meaning provided in section 551(1) of title 5, United States Code;

(2) the term "commercial or industrial activity" includes—

(A) any activity which provides a good or service which can be obtained from a responsive and responsible profitmaking business concern;

(B) such other activity as the Director may prescribe by rule or regulation; and

(3) the term "Director" means the Director of the Office of Management and Budget.

DECLARATION OF POLICY

SEC. 4. (a)(1) The private enterprise system, characterized by individual freedom and initiative, is the primary source of nationa' economic strength.

(2) In recognition of this principle, it is the general policy of the Federal Government and supported by the Comptroller General of the United States, to rely on compet-

itive private enterprise to supply the products and services it needs at fair and reasonable prices.

(3) It is the policy of the Federal Government that, except as provided in paragraph (2), no agency start or conduct any commercial or industrial activity in the agency to provide goods or services for the use of or on behalf of the agency if such goods or services can be procured from any responsive and responsible profitmaking business concern at fair and reasonable prices.

(4) An agency may start or conduct a commercial or industrial activity in the agency only if the head of the agency, after considering all direct and indirect costs of starting or conducting such activity, determines in accordance with cost accounting principles prescribed by the Director under section 6(a)(1) of this Act that there is a clearly identified and demonstrated economic advantage to the Government to start or conduct such activity.

(b)(1) It is further the policy of the Federal Government that, except as provided in paragraph (2), no State or political subdivision thereof use Federal financial assistance to start or conduct any commercial or industrial activity in the government of the State or political subdivision thereof to provide goods or services for the use of or on behalf of the State or political subdivision if the goods or services can be procured from any responsive and responsible profitmaking business concern at fair and reasonable prices.

(2) Federal financial assistance may be used to start or conduct any such activity only if an appropriate official or governing body of the State or political subdivision concerned, after considering all direct and indirect costs of starting or conducting such activity, determines in accordance with generally accepted cost accounting principles adopted by the government of such State or political subdivision in a statute, rule, or regulation that there is a clearly identified and demonstrated economic advantage to the State or political subdivision thereof to start or conduct such activity.

REPORTS TO CONGRESS

SEC. 5. (a) Section 5(a)(1) of the Inspector General Act of 1978 is amended by inserting a comma and "including the identification of cases of violation of the policy set forth in section 4 of the Economy in Government Act of 1982," after "activities".

(b) Section 5(a)(2) of such Act is amended—

(1) by striking out "or"; and

(2) by inserting a comma and "or cases of violation of the policy set forth in section 4 of the Economy in Government Act of 1982" after "deficiencies".

(c) Section 8(a)(1) of such Act is amended—

(1) by striking out "or abuse" in clause (A) and inserting in lieu thereof "abuse, or violations of the policy set forth in section 4 of the Economy in Government Act of 1982";

(2) by striking out "and" at the end of clause (B);

(3) by striking out the period at the end of clause (C) and inserting in lieu thereof a semicolon and "and"; and

(4) by adding at the end thereof the following new clause:

"(D) an identification of each significant violation of the policy set forth in section 4 of the Economy in Government Act of 1982 described in previous semiannual reports on which corrective action has not been completed.".

(d) Not later than ninety days after the date of enactment of this Act, the Secretary of Defense shall submit to the Congress additional provisions for inclusion in the proposed legislation submitted under section 8(a)(5) of the Inspector General Act of 1978. Such additional provisions shall require semiannual reports by the Department of Defense to Congress which shall include the identification of violations of the policy set forth in section 4 of this Act, recommendations for corrective action with respect to such violations, and the identification of previous recommendations on which corrective action has not been completed.

RESPONSIBILITIES OF THE DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET

SEC. 6. (a)(1) The Director shall—

(A) prescribe such rules and regulations and take such other actions as may be appropriate to implement the policy set forth in section 4;

(B) require by rules and regulations that each head of an agency, in determining under this Act if there is a clearly identified and demonstrated economic advantage to the Government to start or conduct a commercial or industrial activity in the agency, consider all direct and indirect costs of starting or conducting such activity in the agency; and

(C) in consultation with certified public accountants employed in the private sector, prescribe by rules and regulations generally accepted cost accounting principles for each head of an agency to apply in determining under this Act if there is a clearly identified and demonstrated economic advantage to the Government to start or conduct such activity in the agency.

(2) Within one year after the date of enactment of this Act, the Director shall submit to the Congress a plan for the gradual elimination of industrial and commercial activities of

the Government conducted in violation of the policy set forth in section 4. The plan shall identify all commercial and industrial activities conducted by the Government and include a schedule for the termination of all such activities conducted by the Government in violation of the policy set forth in section 4 within five years after submission of the plan to the Congress. The Director shall take such action as may be appropriate to implement the plan.

(b) The Director shall take appropriate action to assure the implementation of the recommendations for corrective action with respect to violations of the policy set forth in section 4 included in reports submitted to Congress under the Inspector General Act of 1978.

STATE AND LOCAL GOVERNMENTS

SEC. 7. (a) Notwithstanding any other provision of law, no agency shall provide financial assistance to any State or political subdivision thereof unless the agency receives a certification required by subsection (b).

(b) An appropriate official or governing body of any State or political subdivision thereof requesting financial assistance from an agency shall certify to the extent reasonable and practicable that—

(1) such State or political subdivision will not use the financial assistance to start or conduct any commercial or industrial activity in the government of such

State or political subdivision to provide goods or services for the use of or on behalf of such State or political subdivision if such goods or services can be procured from any responsive and responsible profitmaking business concern at fair and reasonable prices; or

(2)(A) such official or governing body has determined that there is a clearly identified and demonstrated economic advantage to such State or political subdivision to use the financial assistance to start or conduct a commercial or industrial activity in the government of such State or political subdivision;

(B) such official or governing body, in making such determination, has considered all direct and indirect costs of starting or conducting such activity in such government; and

(C) such determination is in accordance with generally accepted cost accounting principles adopted by such State or political subdivision in a statute, rule, or regulation.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT POLICY

AUG 13 1981

Miss Pauline Hildebrandt
Committee on Governmental Affairs
United States Senate
Washington, D. C. 20510

Dear Miss Hildebrandt:

This is in reply to Senator Roth's July 16, 1981 letter requesting the views of the Office of Federal Procurement Policy on proposed Senate Joint Resolution 93. The Resolution would clarify and reaffirm that it is the basic policy of the Government of the United States to rely on the competitive private enterprise system to provide needed goods and services.

This Administration strongly supports a general policy of reliance on competitive private enterprise to achieve a more economic and efficient mode of Government. We, therefore, would welcome a clear statement of intent by the Congress in support of this Executive Branch policy.

We fully subscribe to the entire preamble to the resolution. On the first point, the function of the government is to establish federal policies and manage federal programs efficiently and effectively. In the choice of ways to accomplish this end, we believe that the provision of reliance on the private sector for the goods and services the Government needs has been, by past experience, a responsive, cost effective, and dependable means to perform sensitive and important work.

Secondly, we endorse the statement that the private enterprise system consisting of businesses, both small and large, is the primary source of national economic strength. This country has traditionally looked to the private sector to pave economic paths because of its willingness to take risks, seek innovative solutions to new needs and old problems, reduce costs, and create and use new technology. In this respect, business adds to the federal, state, and local tax revenues instead of using the revenues -- which is the case when the government provides its own needed goods and services.

Further, competitive procurements foster efficiency, economy, and increased productivity in the Federal government. We estimate that the government currently operates thousands of commercial or industrial activities with an annual operating cost in excess of $20 billion, and a capital investment of similar amount. The vast majority of these activities has never been subjected to competition. Available statistics indicate that we could save at least 20 percent of operating costs if these activities were competed, and the private sector cost weighed against the cost of performing the same work in-house.

We endorse the precepts in the resolution with full recognition that our federal employees must also receive fair treatment. The Administration's executive branch policy in this area fully recognizes this by:

- Encouraging agencies to streamline their operations for maximum efficiency before undergoing cost comparison studies;
- Requiring agencies to give priority consideration for placement in other government positions those federal employees displaced by decisions to convert in-house operations to a contract mode of operation; and
- Requiring contractors to give affected federal employees the right of first refusal for jobs under a contract.

These policy provisions are working very well, particularly when government employees fully understand these provisions.

In conclusion, Senate Joint Resolution 93, as introduced, provides timely support for this Administration's quest for a new, revitalized approach to strengthening this country's economy. Economy and efficiency in government and reward of the private sector for initiative, innovation and productivity are necessary ingredients in our formula for economic renewal.

Sincerely,

Donald E. Sowle

Donald E. Sowle
Administrator

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

AUG 21 1981

B-204276

The Honorable William V. Roth, Jr.
Chairman, Committee on Governmental
  Affairs
United States Senate

Dear Mr. Chairman:

Your letter of July 16, 1981, requested our views on Senate Joint Resolution 93 which will clarify and reaffirm that it is the "general policy (emphasis provided) of the Government of the United States to rely on competitive private enterprise to supply the products and services it needs whenever competitive industry prices are available. This policy shall be administered by the Director, Office of Management and Budget, in coordination with the Administrator, Office of Federal Procurement Policy."

Senator S. I. Hayakawa introduced this resolution in response to our June 19, 1981, report, "Civil Servants And Contract Employees: Who Should Do What For The Federal Government?" (FPCD-81-43). We believe this resolution has merit and, if enacted into law, would be an important step toward creating a firm national policy of generally relying on the private sector for goods and services. The resolution, however, leaves some unresolved issues that, in our opinion, the Congress should address if the Office of Management and Budget (OMB) is to administer the policy and issue specific regulations consistent with congressional intent. A discussion of these unresolved issues follows.

BACKGROUND

Since 1955, the executive branch has had a policy that agencies should rely on the private sector for needed goods and services. The current executive branch policy is prescribed in OMB Circular A-76, dated March 29, 1979. Basically, the circular provides that (1) agencies should generally rely on the private sector for commercial goods and services unless it is more economical to provide them in-house and (2) all Government functions must be performed by Federal employees. The General Accounting Office has consistently supported this policy while recognizing that procedures to implement it can be improved.

Our June 19, 1981, report states that executive branch agencies, with few exceptions, have made little progress to implement any part of this policy. OMB information shows that as many as 400,000 Federal employees operate more than 11,000 commercial or industrial activities at a cost of almost $19 billion annually. According to OMB, these employees represent almost one-fourth of the total executive branch civilian work force. Our report concluded that many of these Federal activities provide services--such as janitorial, guard, keypunching, and laundry services--that the private sector could provide in many cases at a lower cost.

We first stated the need for the Congress to establish a national policy of relying on the private sector in our September 1978 report, "Development of a National Make-or-Buy Strategy--Progress and Problems" (PSAD-78-118). We concluded that

--the A-76 policy was not perceived as a national policy with full executive and legislative branch approval and support;

--over the years, policy pronouncements and applications were controversial and unsettled;

--executive departments and agencies' implementation was inconsistent and relatively ineffective; and

--make-or-buy decisions were not necessarily based on sound management principles that would result in an economical and effective Government.

We also pointed out that since 1955, when the executive branch first established a general policy of relying on the private sector, the emphasis has shifted from almost outright reliance on the private sector to reliance with exceptions. Support for the policy vacillated according to the administration in power. Agencies were thus reluctant to invest the resources necessary to implement the policy. For these reasons, we stated a need for a firm national policy, endorsed and supported by both the legislative and executive branches, directing how the Government will acquire its goods and services.

Given the little progress agencies have made since our 1978 report, we continue to believe that a firm national policy is needed. Congressional action can establish a stable national policy that would have the full force and effect of law. Such action would assure that the policy could not be changed again without congressional approval.

COST COMPARISONS

Although OMB Circular A-76 requires agencies to perform cost comparisons to determine when it would be more economical to provide goods and services in-house, most executive branch agencies have not met this requirement. On April 8, 1981, the Deputy

Director, OMB, issued a directive requiring all agencies to accelerate the completion of cost comparisons on commercial or industrial activities operated by over 92,000 Federal employees.

We believe the Congress, in considering Senate Joint Resolution 93, should take a position on the cost comparison issue. The resolution, as currently written, would neither encourage nor prohibit agencies from carrying out OMB's recent directive to perform cost comparisons. If the Congress decides to endorse the concept of requiring cost comparisons, we believe either the resolution or its legislative history should provide OMB with flexibility for making exceptions to the requirement. The following discussion addresses two possible exceptions.

Circular A-76 currently waives the requirement for cost comparisons for critical national defense activities. Presently, many Department of Defense (DOD) commercial activities are operated by military personnel. In the event of war, DOD would have to reassign many of these military personnel and immediately replace them with either civilian or contract personnel. In these circumstances, there would not be sufficient time for DOD to complete a detailed cost comparison before filling the vacated positions.

It might also be necessary for OMB to make exceptions to the general policy in this resolution to recognize other national policies that the Congress has established. For example, the Small Business Act made it a national policy that small businesses, including those owned and managed by disadvantaged persons, receive a fair share of Government contract awards. Consequently, OMB exempted certain authorized small business contracts from the following A-76 requirements: (1) conduct a cost comparison (for new starts only) and (2) review all contracts for possible in-house performance.

Other issues will undoubtedly surface that will require OMB discretion. We believe Resolution 93 should provide this flexibility.

GOVERNMENT FUNCTIONS

Senate Joint Resolution 93 does not currently address the executive branch policy (OMB Circular A-76) that all Government functions must be performed by Federal employees. We believe this policy is of equal importance to the policy that agencies should generally rely on the private sector for needed goods and services. Our June 19, 1981, report indicates that many agencies use contractors to do work that Federal employees should do because the work involves basic management decisions (Government functions). Although contractors may not be making final decisions, we are concerned about the extent to which contractors are influencing agencies' control of Federal programs and policies.

Our report states that if agency cost comparisons show that a large percentage of commercial or industrial work currently provided in-house could be done more economically by contract, agencies should be able to reallocate such positions to work that must be performed by Federal employees--Government functions--without concern for increasing personnel ceilings. Thus, a contractor's involvement in basic management functions is reduced. To encourage agencies to properly allocate their positions, we believe the Congress, in considering this resolution, should endorse the existing policy that all Government functions be performed by Federal employees.

To conclude, if Senate Joint Resolution 93 is to be effective, it must strike a delicate balance between (1) the need to establish a firm national policy on how the Government can acquire its goods and services and (2) the need to keep the resolution's language somewhat general so that OMB has authority to approve exceptions to the general policy the Congress establishes. In our opinion, to establish an effective national policy, either the resolution or its legislative history should address the open issues discussed above.

Sincerely yours,

Milton J. Socolar

Acting Comptroller General
of the United States

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

NOV 3 1981

Honorable S. I. Hayakawa
United States Senate
Washington, D. C. 20510

Dear Sam:

On October 28, 1981, I testified before the Joint Economic Committee on the Impact of Government Competition on Small Business. My testimony centered on implementation of OMB Circular No. A-76, which sets forth the Government's policy of reliance on competitive private enterprise for commercial or industrial products and services required by the Government.

We estimate that the Government currently operates thousands of commercial or industrial activities with an annual operating cost in excess of $20 billion with a similar amount of capital investment. The vast majority of these activities has never been subject to competition. If these activities were subject to the cost comparison studies required by A-76, we estimate that as many as 154,000 personnel spaces could be converted to private sector contract operations with a 5-year cumulative savings between fiscal years 1982 and 1987 in excess of $3 billion. These savings will continue to accrue thereafter.

The potential for such savings has been recognized for a long time. Since 1955, each Administration has expressed a general policy of reliance on the private sector for services needed to support the accomplishment of agency missions. The most recent expression of this policy was published in 1979. However, the policy has been applied unevenly over these Administrations, and it is now time to make it work.

Accordingly, the Reagan Administration would welcome a clear statement of intent by the Congress to support the policy that the Government should not compete with its citizens, and should rely on the competitive private enterprise system for needed goods and services. We, therefore, enthusiastically and fully support the Senate Joint Resolution 93, which you introduced on June 22, 1981. It is an excellent means to clarify and reaffirm this as a national policy and will illustrate to the public and private sectors alike that it is truly the Government's policy to rely on the private sector for needed commercial and industrial goods and services. The Resolution, provides timely support for President Reagan's quest for a new, revitalized approach to strengthening this country's economy. Economy and efficiency in Government and reward of the private sector for initiative and productivity are necessary ingredients in our formula for economic renewal.

Sincerely,

David A. Stockman

David A. Stockman
Director

JUL 9 1982

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

JUL 7 1982

Honorable William V. Roth, Jr.
Chairman, Committee on
  Governmental Affairs
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

This is in reply to your letter requesting comments of the Office of Management and Budget (OMB) and the Office of Federal Procurement Policy concerning S. 2278, "To provide a policy of promoting public sector procurement of goods and services from profitmaking concerns, and for other purposes."

The bill establishes a statutory policy of Government reliance upon private enterprise to provide the products and services it needs at fair and reasonable prices, establishes limitations under which the head of an agency may start or conduct a commercial or industrial activity, sets forth reporting requirements for the Inspectors General and the Secretary of Defense, provides for rules and regulations to be prescribed by the Director of OMB, and applies the policy to State and local governments for activities supported with financial assistance from Federal agencies.

This Administration strongly supports the concept of relying upon private sector business to satisfy the Government's needs for goods and services. This support has been evidenced by vigorous application of the requirements of OMB Circular A-76, "Policies for Acquiring Commercial or Industrial Type Products and Services Needed by the Government," throughout the executive branch and our strong support for S.J. Res. 93.

OMB objects to S. 2278 on the following grounds. First, applying the contracting out policy to State and local governments would be incompatible with the need and the Administration's policy to reduce the Federal Government's intrusion into the activities of State and local governments. Moreover, because most Federal assistance is in the form of grants, either "categorical" or "block," which seek to achieve many varied goals, application of the policies set forth in the bill to State and local governments is both impracticable and inconsistent with the Administration's programs to simplify and streamline Federal grant assistance procedures and substantially reduce the paperwork burden on State and local governments as well.

Second, because the bill limits reliance upon the private sector to "profitmaking business concerns," it eliminates such entities as not-for-profit organizations and universities from consideration as competitive sources.

Third, S. 2278 does not recognize a number of activities that should be exempted, such as military readiness, combat capabilities and intelligence activities.

Finally, cost comparisons of commercial and industrial activities and review of such activities, whether existing or proposed, are matters that are best controlled through administrative mechanisms, as set forth under OMB Circular A-76. We, therefore, believe S.2278 or similarly intended legislation is unnecessary in view of actions taken by the Administration to strengthen Government use of private sector services under Circular A-76.

For the reasons outlined above, OMB opposes S. 2278.

Sincerely,

Naomi R Sweeney

Naomi R. Sweeney
Acting Assistant Director
for Legislative Reference

File #775.01
#700.01
#775.07
#308.01

american
consulting engineers
council

UNITED STATES MEMBER

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May 24, 1982

The Honorable John Danforth
Chairman
Subcommittee on Federal Expenditures,
Research and Rules
460 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Danforth:

Per prior agreement with Mr. Montalto of your staff, this is to provide the views of the American Consulting Engineers Council on S.J. Resolution 93 and S. 2278.

The American Consulting Engineers Council represents 3,800 consulting engineering firms, with over 110,000 professional, technical and administration personnel, from throughout the United States.

Consulting engineers have long been concerned with the "contracting out" problem, particularly in the context of competition from in-house design staffs of the U.S. Army Corps of Engineers, the Bureau of Reclamation and other federal agencies. For example, in the Corps' civil works activities, approximately 75% of all planning and design work is completed in-house. The Bureau of Reclamation has consistently utilized in-house engineers to complete planning and design of major dams, notwithstanding the fact that U.S. private-sector consulting engineers have completed design of some of the largest dams in the world.

In the contemporary environment, examples of avoidance of "contracting out" continue to abound. Over the last several months, the Council was involved in a protracted effort to stave off an Environmental Protection Agency proposal to involve the Corps of Engineers in planning and design activities associated with its $1.6 billion Superfund hazardous waste cleanup program. On an even more current note, we recently learned that the Bureau of Reclamation is apparently investigating the possibility of

15-077 240

President WILLIAM R. RATLIFF Mt. Pleasant, Texas • *Senior Vice President* DOUGLAS C. WOLFANGLE Bloomington, Minnesota
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developing non-federal financing to fund planning and development of hydropower development in Idaho, Utah, Montana, Wyoming and California by Bureau of Reclamation staff.

In addition, there have been numerous recent Congressional initiatives to exempt certain services, employee groups and facilities from the application of OMB Circular A-76.

With this background, allow me to primarily focus on a key question you raised in the hearing: How will we be better off with legislation such as S.J. Res. 93 and S. 2278 than we are currently with OMB Circular A-76?

First, and quite simply, by providing a legislative remedy to the "contracting out" problem, "contracting out" policy will finally be given the force of law.

In addition, we believe a legislative remedy, can motivate more explicit impetus and direction than has heretofore been provided by the Office of Management and Budget to federal agencies to "contract out." In view of the less than adequate implementation of OMB Circular A-76, we believe that federal departments and agencies simply need motivation and encouragement.

We also believe that as the Congress focuses on this issue and alternative legislative remedies, we can bring more clearly to OMB's attention some of the inadequacies in present administrative policies and procedures governing "contracting out."

The need for giving "contracting out" policy the force of law is obvious to those with longstanding involvement with the issue. OMB Circulars, including A-76, only receive the degree of department and agency policy emphasis that the Office of Management and Budget itself insists on. In this regard, past Administrations have frankly not been strongly insistent that the provisions of A-76 be rigorously enforced. For example, with the March, 1979 revision to A-76, federal departments and agencies were called upon to inventory activities potentially subject to "contracting out" requirements, develop comparative (in-house v. outside) determinatives, and schedules for periodic review of those determinatives. To date, with the exception of the Department of Defense, no federal department or agency has made substantial progress in completing these mandated activities, the deadline for which is October, 1982. In our view, these activities will not be completed, more extensions of time will be granted and "contracting out" will remain in administrative limbo.

As you can note from the examples cited above, it has been our experience that federal departments and agencies have largely been able to ignore or avoid "contracting out" requirements. Regretably, we see that trend continuing absent any Congressional action, particularly in the current climate of personnel reductions and budget cutbacks, as public employee unions and government program managers seek to protect their existence.

Finally, we would call your attention to the following inadequacies of OMB Circular A-76, in the hope that they might receive your Subcommittee's close and careful examination:

- It will be difficult if not impossible to develop cost comparison standards that will fully and fairly equate the operations of a government agency with those of a private business. Many comparison items are understated by the government, others are not included and others (such as profit) simply have no equivalent and thus are not stated.

- Even if an adequate cost comparison methodology could be developed, the process by which the comparison is performed is highly suspect. The government is not only charged with developing the methodology but also applying it, without any involvement or participation by private-sector interests.

- Current A-76 cost comparison guidelines automatically "handicap" the private sector by allowing that "new starts" can be undertaken by government unless a ten-percent cost differential is demonstrated (again through government conducted cost comparison).

- There are a number of exceptions to the A-76 requirements which government agencies can and do use to "protect" certain activities from contracting out. One of these is "national defense" which understandably can and should be used to exempt direct combat and combat support activities, but should not be involved to protect a planning and design role for the U.S. Army Corps of Engineers in Superfund (as was originally suggested by the EPA Administrator).

There are a number of provisions in S. 2278, including extension of "contracting out" requirements to federal-aid programs, on which considerable analysis and refinement is desirable. We believe that these and other provisions in the legislation should be throughly scrutinized by the Subcommittee.

As one of the groups most interested in "contracting out" legislation, ACEC believes that S. 2278 represents an important first step in the direction of rectifying a longstanding problem. We understand that the Subcommittee will want to study and possibly improve on its provisions, and we welcome that. We also understand that the legislation serves to confront many important yet politically sensitive issues. In our view, "contracting out" should not be viewed as a subsidy or sot to business, nor should it be viewed as a wholesale assault on public employees performing essential policymaking, management, regulatory and enforcement functions. The issue, as stated by President Reagan recently is basic and clear - "Another priority is to get the Federal government out of competition with private industry in providing goods and services to be used by the Federal government. This is work that small business could be doing and could be doing profitably and yet a lower cost to the taxpayers."

Mr. Chairman, we look forward to working with you on this important issue to find a reasonable and responsible solution, and we thank you for the opportunity to share our views with you.

Very truly yours,

William J. Birkhofer

William J. Birkhofer
Director
Governmental Affaris

WJB:mlo

AFSCME®

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Philadelphia, Pa.
Maynard White
Houston, Texas

June 4, 1982

The Honorable John C. Danforth
Chairman
Governmental Affairs Subcommittee
on Federal Expenditures, Research
and Rules
44 Capitol Hill Apts.
128 C Street N.E.
Washington, D.C. 20515

Dear Senator Danforth:

Recently, your Subcommittee held a hearing on S. 2278, the Economy in Government Act of 1982, which states it is the policy of the Federal government to rely on private enterprise to supply the goods and services it needs and S.J. Res. 93, a resolution to clarify and reaffirm that it is the basic policy of the Government of the United States to rely on the competitive private enterprise system to provide needed goods and services. The American Federation of State, County and Municipal Employees (AFSCME), a labor union representing more than one million public employees, takes this opportunity to oppose these legislative initiatives.

Government procurement policy is established by OMB circular A-76, which was issued in 1966 and revised in 1979. The 1979 revision was due to an extensive investigation (by the Subcommittee on Human Resources) of the Government's practices concerning contracting out for personal services. The results of the investigation revealed:

> "...There is widespread non-compliance with the (procurement) policies which exist;... There is no systematic method of determining when an agency has violated contracting regulations, no mechanism for enforcing those regulations, and no "punishment" for an agency which flagrantly violates the rules...". (House of Representatives Rept. 96-729, Part I, P.9, Dec. 20, 1979).

in the public service

The failure ot some agencies to apply circular A-76 requirements to many contracts let by agencies was also a concern revealed in the investigation.

Upon revising circular A-76, OMB essentially provided that governmental functions should be performed by Federal employees while products and services that can only be provided in the private sector should be obtained by contract...and in all other cases cost effectiveness should be the deciding factor. Now, proponents of contracting out argue that the government should not "compete" in any manner with the private sector. However, AFSCME maintains that by honoring its commitments to provide services to the public, government is not guilty of competition. Rather, it is the aggressive incursion of corporations into the public sector that has put government and its employees in a defensive position, resisting the dismantling of public service. Moreover, AFSCME believes that an essential requirement for a healthy private sector is a vital public sector that can provide the basic services neccessary for sustained economic growth.

Of particular concern to us is the provision in S. 2278 which provides that no State or political subdivision may use Federal financial assistance to produce goods or services in-house that can be obtained from the private sector on the same terms specified for Federal procurement. This would force State and local governments into contractual arrangements that traditionally have been a detriment, not a benefit, to the efficient delivery of public services.

AFSCME does not take the position that all contracting out is bad. Certainly when government jurisdictions lack expertise in a field or cannot finance start-up costs for large projects, using private vendors can be appropriate. However, we also believe the public officials exaggerate the value of contracting out as the answer to high costs and inefficiency. Moreover, the idea that "the private sector can do it better" is simply a myth. Better yet, it's an excuse for justifying poor management in the public sector.

Our experience with contracting out has shown that too often it results in higher costs, not lower, poorer services, not better; a loss of public control and increased chances for corrupt and questionable activities. The comments highlighted below, summarize our major arguments against contracting out:

o Higher Costs. Because private companies are in business to make a profit, the costs charged to the customer must include a profit margin over and above their labor and material expenses.

Also, when planning to contract out, governmental units must consider "hidden" costs for contract administration, including contract preparation and monitoring the contractor's performance. Renegotiation costs should also be considered.

Contractors often offer very low prices in the first year of a contract, hoping the jurisdiction's dependence on their services will enable them to raise prices in the future. Escalator clauses in contracts are one common method for ensuring a rapid rise in a contractor's charges.

o Poorer Services. A common complaint from citizens and public officials is reduced services from unreliable contractors. Often the pressure to maximize profits makes contractors force their employees to "cut corners", thereby reducing labor and material costs. The inability of governments to formulate adequate contract specifications also leads to poor services. Even the smallest task a contractor performs must be stipulated in the contract. For many complex public services, writing the specifications for the contract is very difficult and is done inadequately.

o Lack of Public Control. As soon as a jurisdiction signs the dotted line on a contract, it loses control over the service that was contracted out. Not only are changes in the quality and/or quantity of services difficult to implement, but the average citizen will have little or no impact in registering complaints or making suggestions on how to alter services.

o Corrupt and Questionable Activities. Bribery, kickbacks, payoffs and no competitive bidding have long been associated with contracting out. Some aggressive companies, in a desire to expand profits, engage in illegal practices.

AFSCME therefore, urges you to oppose S. 2278 and S.J.Res. 43. Additionally, we would appreciate your inserting our letter as part of the official record.

Sincerely,

JOSIAH H. BEEMAN
Director of Political and
Legislative Affairs

JB:lms

cc: Subcommittee Members
- Senator Charles Percy
- Senator David Durenburger
- Senator Lawton Chiles
- Senator Henry Jackson

DOOR AND
HARDWARE
INSTITUTE

May 11, 1982

Honorable John C. Danforth
Committee on Government Affairs
Sub-committee on Federal Expenditures,
Research and Rules
Washington, DC 20510

Dear Senator Danforth:

The Door and Hardware Institute would like to submit the following comments for the record for your committee's hearings on the government's contracting out policy.

The Door and Hardware Institute represents nearly 3500 members involved in the distribution and specification of commercial builder's hardware, doors and door frames. Our distributor companies are primarily small businesses with net sales of $1.25 - 2 million. We are particularly concerned about the impact of the government's policy upon small business.

By this time, the government's record of performance in this area is well-known. At best, it could be categorized as uneven. At its worst, it is an inefficient use of our tax dollars. Estimates of the amount of commercial/industrial (c/i) activities performed in-house by the government range in the billions of dollars and certainly the savings on that amount would be substantial.

With budget deficits looming on the horizon, we can think of no better way of controlling the budget of the government than by returning c/i activities back to the private sector. We are confident that the small business sector will take that business and use it to fuel new job-creation efforts as it has done in the past.

The concept of reliance on the private sector for c/i activities has been endorsed by several Presidents, most recently by President Reagan in his State of Small Business Report in January, 1982. The problem, as we see it, is that we have never established an affirmative policy of contracting out

dhi • 1815 N. FORT MYER DRIVE • ARLINGTON, VA 22209 • 703/527-2060

to the private sector, which places the burden on agencies to prove that the work could be done in-house more efficiently before they automatically begin new projects. Further, we believe these agencies must be held to stringent cost comparison standards. We support the efforts of your committee and Senators Hayakawa, Bentsen, East and others. In particular, we note that Senator East's bill, S. 2278, contains such affirmative language. Specifically, it creates the presumption that the government must rely on competitive private enterprise to supply the products and services it needs at fair and reasonable prices. Only if the head of the agency, after considering all direct and indirect costs of starting or conducting such an activity, determines by cost accounting principles that there is a clearly identified and demonstrated economic advantage to the government, shall such activities be conducted in-house.

We have encountered several activities which we believe DHI members can perform more efficiently and at less cost than the government. The first example involves the U.S. Postal Service. Several years ago, the Postal Service announced that it would purchase central delivery mail boxes (cluster boxes) and provide them to postal patrons at no charge. The Postal Service would also maintain the boxes. At that time we contended that we could provide, service and maintain the boxes more efficiently, effectively and economically. The service did not agree, but as a concession, it localized procurement. However, it decided to provide the boxes and service to marketplace, a role historically played by the distributor segment of our economy. DHI believes the Postal Service can achieve its goal of maximizing central delivery efficiencies without assuming this commercial activity - at considerable savings to the government.

A second example is specification writing. Currently, some agencies write their own specifications for commercial constructions while others rely on the private sector. Architectural Hardware Consultants (AHC's), which have passed a certification examination, have traditionally performed this service, for a fee, for the builder's hardware portion of a construction specification schedule. We recognize the need for trained individuals in government service to protect the government's interest, but we believe the actual specification writing can be done more efficiently and at less cost by an AHC working on a fee basis.

In summary, we believe it is in the best interest of our economy, and consistant with the need for government fiscal restraint, to adopt a firm contracting out policy. Thank you.

Sincerely,

John SATAGAJ

John S. Satagaj
General Counsel

JSS:dc

STATEMENT ON BEHALF OF
THE NATIONAL AUDIO-VISUAL ASSOCIATION

By

Kenton Pattie
Senior Staff Vice President

UNFAIR COMPETITION

Prepared for the
May 19, 1982 hearing of the U.S. Senate
Subcommittee on Federal Expenditures, Research, and Rules
Committee on Governmental Affairs
Chairman: Senator John Danforth of Missouri

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UNFAIR COMPETITION

Chairman Danforth:

On behalf of the National Audio-Visual Association, I wish to thank you for your leadership in holding public hearings May 19 concerning legislation dealing with unfair competition.

While the Senate has looked briefly at this matter during this Congress — for example, in the Small Business Committee and in the Joint Economic Committee -- we feel that your Subcommittee has the Senate's mandate to take all the legislative steps needed to solve the problem.

Already, during this Congress you have shown extraordinary leadership qualities by initiating and completing work on legislation to get the government to pay its bills on time. Unfair competition is much like delinquent payments: both irritate small businesses, both pit the taxpayer's government against the taxpayer, and both earn only disrespect for the government. Unfair competition goes even one step further: it denies the government tax revenues which would be generated by private firms.

Direct Competition

For many years, one of the major competitors for NAVA members who produce instructional and training materials, films, filmstrips, records, videotapes, and audio tapes was the U.S government. During the 1970's NAVA worked hard through the administrative route to solve this problem. Working with officials of the Nixon, Ford, and Carter administrations, we succeeded in getting increased reliance on the private sector for the production of government films and videotapes. It took thousands of hours of work, numerous letters, and meetings. We had the support of several members of Congress who reserved the right to take legislative action in the event the matter was not resolved by the executive branch.

Meanwhile, we are advocating within the executive branch that government agencies rely on the use of licenses to enable private firms to distribute government-funded audio-visual products. We have in the Department of Education one very successful model program called "Market Linkage" which has saved the taxpayers thousands of dollars by relying on private sector firms to distribute instructional materials for the handicapped. This particular program actually returns royalties to the government. This reliance on the private sector should be encouraged by Congress and we are convinced that the legislation you are considering will help us in the efforts we are making to get executive branch acceptance of the idea.

Indirect Competition

The problem of the 80's is indirect competition. By indirect, we mean that Federal grant and contract dollars to educational institutions and other non-profit groups are being used to create, produce, and market instructional materials, films, filmstrips, records, microcomputer software, videotapes, and audio tapes.

When Federal grant funds are combined with these organizations' tax-exempt status and with their access to non-profit postal rates, these organizations have a competitive advantage that can be called only one thing: unfair.

Legislation

Therefore, we believe that S. 2278, the Economy in Government Act, offers a reasonable remedy in Section 4 (b)(1) by stating that:

> ". . . no State or political subdivision thereof use Federal financial assistance to start or conduct any commercial or industrial activity . . . to provide goods or services for the use of or on behalf of the State or political subdivision if the goods or services can be procured from any responsive and responsible profit-making business concern at fair and reasonable prices."

We recommend that this provision be included in any legislation reported out by this Subcommittee. Further, we recommend that the Subcommittee extend the coverage of this paragraph to any non-profit organization which receives Federal financial assistance. For example, as drafted, this paragraph of S. 2278 would stop a state university from using Federal funds to underwrite a business activity, but would not stop a private university from doing the same thing. Since public and private grant recipients have the same Federal funding souces, the same rules against unfair competition should apply.

This can be remedied by an amendment which would read:

> ". . . no State, political subdivision thereof, or non-profit organization use Federal financial assistance to start or conduct any commercial or industrial activity . . ."

We recommend that the Subcommittee consider making this amendment when the bill is marked up.

Having reviewed S.J. Res. 93, and S. 1903 as well as S. 2278, we have concluded that the legislation most likely to succeed in solving the entire array of unfair competition is S. 2278. We are most grateful to Senator East for introducing this bill. The Senator and his staff member Hal Gordon sought the views of NAVA and other small business organizations and we appreciated being consulted in the drafting of such an important bill.

We are most grateful to Senator Hayakawa for pioneering this subject. During the Hayakawa hearings titled "Government Competition With Small Business" in 1981 witnesses submitted several examples of indirect competition. There were other examples of indirect competition in the Small Business Administration Advocate's report on government competition.

To assist this Subcommittee further, we are currently compiling a NAVA white paper on unfair competition. In doing so, we are bringing together a sample of the examples known to our industry. We feel this research will assist you in convincing the Senate of the need for a provision such as Section 4(b)(1).

Meanwhile, Senator Danforth and Subcommittee members, we are most grateful to you for your interest and concern in this matter. We fully recognize the political perils of a policy which prohibits public sector production of goods and services. Without question, this is a sensitive matter because until now, in the absence of any clear policy, state governments, universities, and other non-profits have proceeded with very little guidance. In fact, many tell me that they have been urged by Federal agencies to "sell," to "increase funding sources from sale of services," or to "compete in the marketplace in any way we can to raise some extra dollars." In one case, members of Congress have admonished a group of non-profits to copy the sales programs of for-profit firms.

We understand the pressures on these organizations to get extra mileage from their Federal assistance dollars. We recognize that when Federal funds are being reduced by Washington they are looking to other revenue sources such as are traditionally reserved for the private sector.

But, while we recognize their problem, we do not condone the incursions they are making into the private sector. We believe that the time has come for this Subcommittee to draw a firm line between what can and cannot be done with Federal dollars. And this line should clearly halt the invasion of the government sector into the private sector.

If we don't resolve to stop the invasion now, in the 1990's we will find that government will have grown bigger, small business will have grown weaker, and the tax revenues that support the government and non-profit sector's business enterprises will be generated by fewer and fewer firms.

Even today, there are NAVA firms whose biggest competitors are subsidized by the Federal government, pay no taxes, and use non-profit mailing rates. There is more of this competition in our business today than there was 10 years ago.

Members of NAVA report that their tax-exempt competition, helped by Federal subsidies, is a growing factor in all phases of the marketplace. The time to stop the trend is now.

While we feel there are some legitimate jobs being done by state governments and universities, such as in distributing publications and films that would not otherwise be available to the public, we feel that these examples should be the exception rather than the rule.

In Conclusion

The National Audio-Visual Association encourages the Subcommittee to report out a bill similar to S. 2278 and in particular to include a provision as drafted in Section 4(b)(1) of S. 2278. This provision should contain an amendment to extend the coverage to non-profit organizations.

Thank you for holding this hearing. We look forward to working with you, the Subcommittee members, and Bill Montalto in the months ahead to solve the problem of unfair competition.

NATIONAL TAXPAYERS UNION

A NONPARTISAN, NONPROFIT ORGANIZATION DEDICATED TO THE PUBLIC INTEREST

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James D. Davidson
Chairman

George E. Snyder
President

May 27, 1982

The Honorable John C. Danforth
Chairman, Subcommittee on Federal Expenditures,
Research and Rules
United States Senate
Washington, D.C. 20510

Dear Senator Danforth:

The National Taxpayers Union, representing 450,000 family members, fully supports S. 2278, "The Economy in Government Act of 1982."

We have long supported private delivery of public services because of the potential for large budget savings and service efficiency. In conjunction with the Local Government Center, located in Santa Barbara, California, the National Taxpayers Union published a 46 page handbook titled "Cut Local Taxes -- Without Reducing Essential Services." It documents case after case of how local governments can save money through privatization and other managerial strategies. Since we published it six years ago, it has sold approximately 15,000 copies through our newsletters and by word of mouth.

The Economy in Government Act, by Senators John East and S.I. Hayakawa, would vastly help reduce barriers to privatization on the federal level. We think it has the potential to save taxpayers hundreds of millions, if not billions, of dollars annually.

At first glance the source of the savings are unclear. After all, the federal government does not have to make a profit nor does it have to advertise. How can private contractors possibly provide services for less money than the government can? As Robert W. Poole, Jr., author of our "Cut Local Taxes" handbook and author of the new book "Cutting Back City Hall," writes, "it turns out, in fact that in nearly every case that's been studied, private firms are less costly than public agencies for delivering the same level of service. Documented cost savings range from 50% (fire service in Scottsdale, AZ) to 40% (national average saving for private garbage service in cities of over 50,000 population) to 30% (data processing in Orange County, CA) to 10% -- 20% for services like tree trimming, pavement striping, and maintenance."

The long experience at the local level proves time and time again that private firms can deliver government services for less. Why? The answer is incentives.

As you know, in the private sector there are clear yardsticks to judge how well human needs are met and how efficiently services are performed. When a business or a branch of a corporation does a bad job it loses money or its profits decline. It then either goes out of business or its operations are scaled back.

This is not the case in the public sector. If anything, the opposite is true.

Economists James Bennett and Manuel Johnson point out that, "neither the carrot nor the stick encourage efficient performance in the public sector . . . . There is no discipline imposed on the bureaucrat by the marketplace: The public firm is typically isolated from all competitive pressures by legislative fiat. . . . Once an appropriation is allocated to (a government agency), there is little incentive for the bureaucrat to produce the agency output at minimum cost. Any funds remaining from the Bureau's budget cannot increase the salary of the bureaucrat, for incentive or profit sharing plans are not used in the civil service."

Private contractors know they have to stay on the ball. If they don't, another firm will win the contract when the current one expires. There is also far more incentive to innovate. If a firm finds a cheaper way of providing particular services it can make the best bid for the next contract and make more money at the same time.

There are other advantages. By contracting, the federal government knows exactly how much the services cost. It reduces the need for administrative staff, whose costs are sometimes difficult to apportion. It also eliminates the possibility of massive hidden unfunded public employee pension liabilities that may come due in the future.

Privatization also makes it easier to compare costs. With a similar service being provided by a private firm, government managers can compare their agency's performance to that of the private firm. They can also be more objective about service performance. It's only natural that managers tend to be somewhat less than objective when evaluating the performance of their own division. But when evaluating the performance of an outside contractor, managers find it much easier to be objective.

Privatization also enables government managers to pay more attention to monitoring performance rather than directing the day to day operations of performing the service.

It should also provide Congress with better information on government services. Properly written contracts would specify the services to be performed as well as their cost. These documents should be available to the general public so that Congress and the public can monitor performance to ensure that the government gets good value.

To illustrate the potential of privatization, I have enclosed two articles by Robert Poole on some of the innovations that have occurred at the local level.

We hope the Committee will soon approve the Economy in Government Act of 1982.

Please make this letter and its enclosures part of the formal hearing record.

Sincerely,

David Keating
Director of Legislative Policy

DK/kd
Encl.

Contracting Rescues California

by Robert W. Poole, Jr.

July 1, 1981, the beginning of a new fiscal year, was supposed to have been the moment of truth for California cities and counties. With the state budget surplus finally down to zero, there would no longer be large amounts of state aid available to cushion the impact of Proposition 13, which had slashed property taxes three years before. Thus, as recently as last spring, pundits were predicting layoffs and service cutbacks as of July 1st.

It didn't happen. And a big reason why it didn't is the steady growth of contracting out public services over the past three years. A recent survey by the California Tax Foundation showed that 87 out of 92 responding cities, counties, and districts are involved in contracting. The services range from basic public-contact activities like fire protection and trash pickup to internal housekeeping functions like data processing and vehicle maintenance. And the most common reason for deciding to contract out a service is . . . you guessed it, to save money.

The city of La Mirada is one of the best examples of the potential of the contracting process. This 40,000-population suburb of Los Angeles has just 55 municipal employees—and over 60 service contracts. Some of them—like police and fire protection—are with the county government. Even here the city ends up saving money, because the county is able to spread its fixed costs (for things like jails and computer systems) over many users and ends up charging La Mirada only the marginal cost of additional patrol units and fire companies. But most of La Mirada's contracts are with private, profit-making firms. Among the many such services are data processing, traffic signal maintenance, park maintenance, refuse pickup, and dial-a-ride.

Besides cost savings, La Mirada finds that service quality is the second major advantage of contracting. City administrator Gary Sloan points out that he and the city council have far greater control over private contractors than they would over city departments. "I can, and have, turned a contractor around in six days," he told *Government Executive* magazine recently. What makes possible such responsiveness is that (a) the city writes "very tight contracts" and (b) the contracting firms can be highly flexible in using personnel, unlike municipal agencies constrained by civil service rules.

Another local government which has been taking increasing advantage of contracting out is Los Angeles County. In the 28 months since a charter amendment gave county officials a free hand in contracting (provided they can show each instance to be cost-effective), the county has awarded 58 contracts totaling $8.2 million. Had these same services remained in-house, the county estimates it would have spent $3.3 million more. Thus, the overall savings are about 29 percent.

Individual contracts often save far more than that. For example, when the county went out to bid for security services at Hollywood Bowl last year, the winning bid from U.S. Guard Service represented a saving of nearly 49 percent. Similarly impressive savings have been realized on a number of contracts for park maintenance. Overall, the county supervisors are counting on contracting out to make possible a reduction of 10,000 in the county's 80,000-member work force over a three-year period, to be achieved largely by attrition.

La Mirada and Los Angeles County are hardly the exception. The California Tax Foundation survey found that contracting is in full swing throughout the state—in the majority of cities, counties, school districts, and special districts. The average city responding to the survey has eight contracts in force, mostly with the private sector. Among the areas most commonly contracted out are public works, health services, animal control, parks and recreation, transportation, and various housekeeping services such as maintenance of buildings, equipment, and vehicles.

Counties responding to the survey averaged 12 contracts apiece, mostly in the same fields as cities but also including air pollution control and ambulance service. School districts have much less flexibility in contracting, being limited primarily to support services. Data processing and maintenance services are the ones most commonly contracted out by school districts. Special districts averaged eight contracts apiece. The largest user of contract services is the East Bay Municipal Utility District, which has 49 contracts, equally divided between operational services and support activities.

The Moral

There are several lessons to be drawn from the California experience. The first is that large-scale tax-cutting via Proposition 13 has not crippled local governments at all. On the contrary, it has provided the motivation to seek out more cost-effective methods of providing public services. And contracting with private-sector firms has proven itself as one of those methods. A second lesson is that besides offering overextended local governments a way to retrench, contracting provides an alternative path for newly formed cities. La Mirada has been a contract city since it incorporated in 1960. By seeing their role primarily as managers and facilitators, rather than as service providers, city officials have prevented the growth of a bureaucratic empire.

Officials and taxpayers across the country can profit from California's experience with contracting. A good way to begin is to read the Cal-Tax report. Called "Contracting Out Local Government Services in California," it's available for $4.00 from the California Tax Foundation, 921 Eleventh St., Sacramento, CA 95814.

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Fiscal Watchdog:
Privatization In Europe

by Robert W. Poole, Jr.

The idea of hiring private-sector firms to perform public services is hardly unique to America. Indeed, some of the most interesting examples of privatization can be found on the European Continent.

> ***". . . reduced cost, increased productivity and improved control over performance."***

The oldest and largest private service firm in Europe is the Falck Company, which provides fire and rescue services to half of Denmark. The company was begun by Sophus Falck in 1906 to provide fire rescue services, but soon expanded into ambulance and towing services as well. By the 1930s the company's services had become so widespread and so popular that cities began to hire Falck as a replacement for their municipal fire and ambulance services.

One of Falck's principal advantages is lower cost. As do private fire departments in this country, Falck supplements its 3,300 full-time personnel with 1,200 paid reservists, thereby holding down overall labor expenses. In addition, Falck derives part of its revenue from annual road-service subscription fees paid by over a million families (much like the Auto Club in this country). Falck subscribers receive both emergency road service and ambulance paramedic service for a single annual fee. Out of 279 municipalities in Denmark, 271 contract with Falck for at least one service.

West Germany has also gotten into private policing, though on a more limited basis. A number of local governments, especially in Bavaria, hire private security firms for specialized policing functions—e.g., patrolling Munich's subways, providing security at the Olympic Park grounds, and patroling a large mental hospital complex in the Munich suburbs.

Many German cities employ a quasi-privatization approach to providing various services. Rather than hiring a private firm to provide, say, garbage collection, they set up an autonomous publicly owned but profit-oriented agency to perform the service, funded entirely by user fees. While not providing the beneficial effects of competition, this approach nevertheless forces strict cost-accountability and performance measurement on agency managers. Being able to identify cost and performance in this manner has made it easier for city officials to compare such agencies with private competitors—and has led a number of middle-size German cities ultimately to switch to private firms.

Among the other services being provided under contract in Germany are public housing management, park and swimming pool operation, janitorial services, snowplowing, and even burials. Concludes Hamburg municipal productivity expert Dr. Berend Kruger, "It's a fact that private enterprise works more efficiently." Some German cities are saving as much as 50% in privatized services.

France, too, makes use of quasi-private entities, called "Societe d' Economie Mixte," to provide various large-scale public projects such as roads and water and sewer systems. These self-financed entities operate under the direction of local government, but without burdening the taxpayers.

One of the most interesting forms of privatization also occurs in France: building inspection. France has never had rigid government-enforced building codes such as those in the United States. Instead, French law simply imposes strict civil liability on builders for the quality of construction (10 years for major structural systems). To protect themselves against claims, builders purchase warranty insurance. And the insurance companies, in turn, hire private inspection firms to inspect the buildings under construction or rehabilitation. The four nationwide inspection firms use a variety of codes and standards to assess the quality of the work. Since both mortgage lenders and casualty insurers rely on these inspections—after all, it's *their* money that's at risk—there are strong incentives for the inspectors to be thorough. At the same time, the decentralized, private-enterprise nature of the system makes it much more open to performance-oriented standards and technological innovation than a building code system which has the force of law.

"Privatization and contracting of services offer outstanding advantages to inflation- and bureaucracy-weary citizens," concluded analyst Mark Frazier in a report on these European developments for the German Marshall Fund. Among the advantages are reduced cost, increased productivity, and improved control over performance. It's not hard to see why privatization is catching on—on both sides of the Atlantic.

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TESTIMONY OF PHILLIP S. WOODRUFF

TO THE

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

ON THE

ECONOMY IN GOVERNMENT ACT OF 1982

WASHINGTON, D. C. JUNE 15, 1982

SUMMARY

*** Supports SJ Res 93 (HJ Res 294) which clarifies and reaffirms the policy of the federal government to rely upon the competitive private enterprise system to provide needed goods and services.

*** Supports S.2278 which extends this policy to the applicable state and municipal entities --- particularly where federal funds are involved.

*** Identifies critical problems resulting from the establishment and development of competitive government owned and operated businesses at the state and local level which thwart the objectives of the private enterprise, and often lead to illegal trade restraints, and other anti-trust and civil rights laws.

*** Identifies serious problems facing small businesses which prevent or hinder the resolution of problems involving competitive government businesses, such as legal immunities for government, cost of litigation, and formation of government coalitions against private business.

*** Recommends the establishment of a formal oversight procedure specifically to provide assistance to businesses adversly affected by the activities of government owned businesses which unfairly compete with the private sector, in violation of federal policy and law.

TESTIMONY OF PHILLIP S. WOODRUFF

TO THE

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TESTIMONY

Reaffirmation of the policy of the Federal government to rely upon the competitive private enterprise system to provide needed goods and services is a much needed and worthwhile clarification of federal government policy.

My comments regarding SJ Res 93 are intended to emphasize the importance of both government and business at all levels to recognize the benefits to be gained by relying upon the competitive free enterprise system to provide needed goods and services.

Another major objective is to contribute strong support for the adoption of S. 2278 clarifying federal policy, and seeing the policy implemented and enforced in a fashion that would preclude State and municipal government entities from thwarting, the intended results, and cause States to enact a parallel policy which will enhance the success of the Economy in Government Act of 1982.

Rather than address issues such as use of government consultants, protection of classified information, etc., which have been adequately addressed by others, I shall focus my comments to the concern for the small business which finds itself in open and direct unfair competition with government owned and operated businesses which are armed with many economic, political, and legal advantages used to undermine the efforts of private enterprise and circumvent the intent of existing and proposed policy and legislation.

My intent is also to draw attention to the importance of providing resources and effective avenues of remedy for small businesses which often are restricted from successfully challenging the unfair actions of government bodies because of financial capabilities, political sensitivities, and power structures which form often insurmountable barriers to the vulnerable small business.

It is significant to note that when a state entity, such as a state supported university, creates a business which competes openly in the marketplace against the private entrepreneur the overall advantages are overwhelmingly in favor of the state-owned business.

In our case it became impossible to survive in the general aviation fixed base operation (FBO) business not simply because of government competition, but because of the state owned and operated businesses' monopolistic powers granted by other state agencies and local authorities, and their continuing utilization of state, local and federal funds to favor the government business. Combined, the government groups tend to form a coalition which prohibits the opportunity to resolve existing inequities at each level of administrative review.

A brief description of my experience in the general aviation sales and service fixed base operation (FBO) business and my concerns which lead to support for SJ Res 93 and S. 2278 follows.

For many years it had been my ambition to own and operate a successful professional general aviation sales and services fixed based operation. My preparation has been both broad and extensive. After, serving in the U.S. Army's 82nd Airborne Division where I completed my initial pilot training, I attended college, completed my advanced pilot training, and earned a B.S. degree in Management. Subsequently, I developed the necessary industry experience and personal resources to successfully accomplish this goal. My objective was to create a new enterprise and develop it to its fullest extent to serve the general and commercial aviation needs of Southern Illinois, my home.

In 1978 I was invited and encouraged by Southern Illinois University (SIU) and Southern Illinois Airport Authority (SIAA) to establish a new general aviation sales and service fixed base operation (FBO) business at Southern Illinois airport in Carbondale, Illinois. This is a public airport constructed primairly with federal funds.

Initially, I was assured by both parties that while the Southern Illinois University (SIU) also owned and operated an FBO, it had neither the capability nor desire to provide the needed goods and services to the public sector, but rather they intended only to provide services to bonafide university administration, staff, faculty and students traveling on university business or for educational purposes, thus providing an excellent opportunity for establishing a business to serve the public sector as well as univerity business which could not be handled by the university owned FBO.

My general aviation fixed base operation (FBO) was conceived and organized in 1978 to provide aircraft charter, pilot education, flight training, aircraft sales and services to the public surrounding Southern Illinois Airport.

When my business opened in the Spring of 1979 it appeared that through everyone's efforts a model development of private industry, education, and government working together to provide the aviation needs of our community had been created.

Very soon after operations began, this new business had gained the support of the community and the general aviation public; resulting in a successful and profitable start-up, and providing the feasibility of expanding the business to its greater potential.

As a variety of new plans and programs were implemented, this enterprise was apparently preceived as representing a formidable threat to the university owned and operated fixed base operation. As time passed, the business saw a series of changes in the attitudes, actions and structures of both the university and the airport authority.

The university owned FBO began by increasing its level of directly competitive activities utilizing state owned aircraft, and by increasing prices to my firm for aviation fuels and services for which they were the sole suppliers. Perhaps as significant were the appointments of additional university employees and associates to the airport authority board. Ultimately university employees served in two key positions: airport manager and chairman of the airport authority board of commissioners. Also, a partner of our corporate general counsel was retained as airport attorney and appointed to the board of directors at our bank.

From this point forward my company was subjected to unfair pricing, refusal and delay of facility, program, and service expansion plans - and a host of other roadblocks to progress - all of which contributed to the continuation of a monopolistic operating environment which strongly favored the university FBO at the expense of our small business.

Ultimately I was forced out of business due to the joint effortsof our adversaries, the result of which has been the loss of more than 20 jobs and over $500,000, plus the loss of many much needed aviation services to the public.

Throughout the ordeal, as alternatives were searched for which would enable my company to remain in business, it became increasingly evident that the conflicts of interest and activities among members of the airport authority and the university were extremely prolific and deep-rooted. The actions and operating agreements strongly favored the government owned business. These circumstances represented such insurmountable barriers to the development of my business, that my attorney recommended closing the enterprise at Southern Illinois Airport on December 31, 1980, upon the initial expiration date of the contract.

The appeals for political assistance in resolving the problems initially proved fruitless because of the lack of legislation dealing with the issue of unfair government competition, the political influence of the university, the airport authority and other state entities which engaged in similar activities. However, as the facts became known to various agencies, associations, and individuals I became more aware of the magnitude of the problem as a national issue, and the difficulties involved in resolving the situation.

Consequently, the sole remaining alternative was to seek legal recovery under the applicable federal and state laws. In addition to the substantial financial committment required to litigate a case as complex as mine, I am also confronted with the realities of immunities for certain government bodies and the overwhelming power, influence, and resources of such groups in both the political and legal arenas.

Consider these factors and developments, which relate directly to developing conflicts of interest, monopolistic activities, discriminatory arrangements, and other unfair business practices, and it becomes clear why it is essential to structure federal policy to have the immediate effect of eliminating unfair government competition at all levels as well as fostering the development of a proper working relationship between government, private industry and education which will prevent future conflicts and benefit all concerned.

It is for this reason that I consider it of paramount importance that the embodiment of SJ RES 93 and S. 2278 policy clearly extend to state and municipal governments, especially for projects which receive federal funds.

It is my premise that each of these segments of society have both mutual and individual objectives which can be effectively achieved by working together in the spirit of co-operation rather than as adversaries and competitors, simply by each segment performing their respective roles and contributing to the success of each other.

It is clear that government competition with private enterprise takes many forms and is among the most devastating of factors to small business, particularly when the competition becomes open and direct, as well as fostering an operating environment which is violative of the various anti-trust laws, and when the government has many superior economic advantages, political influence, and legal immunities ... and significant advantages in the courts of law.

It is for this reason that I recommended the establishment of oversight procedures which will provide immediate and effective assistance to businesses adversely affected by the activities of government owned businesses.

I strongly suggest that if government wishes to engage in the conduct of business in competition with private enterprise, the government business should at least be subject to the same set of rules dictated to private industry. And the same benefits extended to government business should be available to the private enterprise system.

It should be understood that the interests of Woodruff Aviation Company, Inc. involve two areas of activity: legal and political. First, the legal action which will hopefully enable our firm to recover and survive. Secondly, the political efforts such as this testimony which will hopefully contribute to eliminating similar problems for other private businesses and government entities in the years ahead.

Thank you, Mr. Chairman, for this opportunity to present my views on such an important topic.

ATTACHMENT

INDEX OF ASSOCIATIONS, AGENCIES, AND INDIVIDUALS

I wish to extend my thanks and appreciation to those who have supported and encouraged my efforts, including:

- NATIONAL FEDERATION OF INDEPENDENT BUSINESSES.
- U.S. CHAMBER OF COMMERCE.
- NATIONAL AIR TRANSPORTATION ASSOCIATION.
- AIRCRAFT OWNERS AND PILOTS ASSOCIATION.
- U.S SENATE COMMITTEE ON SMALL BUSINESS.
- U.S SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS.
- CIVIL AERONAUTICS BOARD.
- FEDERAL AVIATION ADMINISTRATION.
- FEDERAL TRADE COMMISSION.

Phillip S. Woodruff

"CONTRACTING OUT"

Under OMB Circular A-76

The Policy of Government Reliance
Upon the Private Sector
to Provide Needed Goods and Services

A primer prepared by the EIA Service Contracts Committee as a service in the National Interest

ELECTRONIC INDUSTRIES ASSOCIATION
2001 Eye St., N.W. Washington, DC
20006

PURPOSE

This primer was prepared to afford all interested parties, including members of Congress, their staffs, representatives of Government agencies and the media, a concise overview of the principal factors and issues involved in Government decisions to contract out.

DEFINITIONS

"Contracting Out" is the term generally used to describe private sector performance, under contract, of activities which provide goods or services to meet established Government needs.

A Government commercial activity is any activity operated by an Agency which provides a product or service that could be obtained from a private commercial source.

When an existing Government activity is competed, and subsequently contracted out for industry performance, it is known as a "conversion."

BACKGROUND

Although historically a basic tenet of the free enterprise system, the policy of "contracting out" was first formally expressed in 1955 in the Bureau of the Budget (BoB) Circular 55-4. This guidance was eventually expanded in scope and incorporated as current policy by OMB Circular A-76. To minimize confusion and to assure accurate comparative calculation of in-house (Government) costs vs. contract cost, a comprehensive Cost Comparison Handbook was published in 1979 and is available from OMB's Office of Federal Procurement Policy (OFPP).

MAGNITUDE

The Federal Government spends approximately $20 billion per year on more than 11,000 Government commercial activities, which utilize $10 billion in capital equipment and facilities. The Office of Management and Budget has estimated that complete implementation of OMB Circular A-76 policy and review of these commercial activities would result in savings of $5 billion in FY 1982-87, and elimination of 154,000 Federal personnel positions.

MYTHS AND FACTS ABOUT CONTRACTING OUT

Myth: Industry performance is undependable since industry workers can strike, while Government workers cannot.

Fact: Service contractors have generally been able to handle labor relations in a manner that has avoided strikes, and contracts can be written to include no-strike provisions and/or contingency plans for providing continued performance in spite of a strike. Federal Postal and Air Traffic Control employees have dramatically demonstrated the capacity of Civil Service workers to obstruct performance of essential functions. Increased militancy and willingness to engage in disruptive tactics have become more apparent in recent public sector unions' tactics and rhetoric.

Myth: Incumbent Federal employees will lose their jobs if an in-house function is converted to industry performance (contracted out).

Fact: Current employees in activities converted to private sector performance are not simply turned out to join the ranks of the unemployed. Many are reassigned to other Government positions and OMB Circular A-76 guarantees a right of first refusal to these personnel for openings on the contract for which they are qualified. Experience shows that, on average, 85% of these employees accept jobs with the incoming contractor.

Myth: Industry performance of critical defense support functions would be undependable in wartime, and the Government would find itself high and dry in hot spots abroad when industry personnel evacuate their posts.

Fact: In each major conflict since World War II, the U.S. Government has relied heavily on dedicated, dependable industry employees, many of whom have willingly served in combat conditions or other dangerous circumstances in support of our forces.

Myth: Industry engages in "buy ins", bidding unrealistically low prices to gain a contract award, and then greatly increasing prices in succeeding years.

Fact: Contractors do not generally bid unrealistically low prices to gain an award, nor would they be able to rapidly inflate prices in succeeding years. Periodic recompetition of contracts ensures realistic pricing, and GAO has found, in a 26 August 1981 study (PLRD 81-58), that buy-ins were not apparent in a representative list of functions converted from in-house to contract performance between April 1978 and October 1980.

Myth: Industry personnel are not as responsive as in-house employees and make it more difficult for Government managers to perform their assigned functions.

Fact: By producing well defined, performance-oriented statements of work when contract proposals are solicited, Government managers can eliminate any such problem. (The OFPP has written an 89-page handbook on defining these work statements.) Contracting out can also add to Government options and flexibility since it is much easier to modify or eliminate a function by simply amending or terminating a contract than to abolish or revise a Government activity and have to reassign affected personnel.

Myth: Contracting out is a bad deal for the Government because of the hidden costs which accrue to it in attempting to supervise contract performance.

Fact: Circular A-76 guidelines require that all such additional administrative costs be included, as costs of contract performance, in cost comparison decisions. Comparison guidelines do not favor contractor over in-house performance, and in areas such as general and administrative expenses, retirement benefits, and facilities amortization, current guidelines tend to understate the cost of Government performance. Despite these biases toward in-house performance, a significant number of cost studies demonstrate substantial savings possible through contracting out. In addition, by being forced to think in competitive terms and compare performance costs with established industry standards, many Government managers are incentivized to make their operations more efficient and cost-effective, thereby producing savings to the Government regardless of whether the function is eventually contracted out. In the Department of Defense, experience has shown savings on the order of 20% accruing to the Government by the introduction of such competitive performance criteria.

Myth: Contracting out is a risky business because reliance on non-governmental personnel can adversely impact Defense readiness.

Fact: Overwhelming evidence indicates that reliance on civilian contractors for commercial activities in support of our armed forces can actually *enhance* combat and emergency readiness. By freeing scarce and expensive active duty manpower from non-combat roles, allowing their reassignment to more critical military duties, readiness can be promoted. The U.S. private sector has for generations performed with distinction in developing, manufacturing and maintaining our nations' strategic and tactical weaponry and support systems.

Many thousands of civilian contract personnel performed critical maintenance, repair and training functions in support of U.S. Forces in Vietnam and other conflicts, and many of these personnel lost their lives in performing these functions in the face of enemy action.

Myth: Contracting out only benefits large businesses, and has little or no effect on business opportunities for small firms.

Fact: Large business is the largest single employer of small business through subcontracting of many smaller functions. Moratoriums and other restrictions on contracting out, even if limited by selective functional exemptions, can have a definite impact on small business opportunities, an impact which the U.S. Chamber of Commerce has called "devastating."

A March 1980 Report by a Task Group of the Small Business Administration has also demonstrated that the biggest threat to small business in the Government marketplace is not large business, but rather in-house Governmental performance of commercial activities in direct competition with small business suppliers. The task group report determined that small business opportunities could be enhanced by more complete implementation of Circular A-76, as well as reinstitution of a *preference* for private sector performance of Government commercial activities.

Myth: Contracting out of security or firefighting services at Federal installations poses unacceptable risks, because only public sector employees are trustworthy enough to perform these key functions.

Fact: Private sector firms have been providing these key services effectively and at greatly reduced cost at atomic energy facilities, missile test ranges, nuclear weapons and ammunition plants, and all NASA space flight centers for more than 30 years. Defense Secretary Weinberger and other top government officials have noted the excellent services provided by contractors at even the most sensitive government installations. Municipal and other local government authorities often rely extensively on private sector firefighting services, and this reliance has usually resulted in lower insurance premiums and savings of 30-50% over comparable public-sector service. In these cost and quality-conscious times, it is difficult to understand how the Federal Government can ignore the potential inherent in private sector performance of these essential services.

EXAMPLES OF COST SAVINGS THROUGH CONTRACTING OUT

In a recent industry study of over 60 functions converted by the Defense Department from in-house to contractor performance, average cost savings of 51% was demonstrated. Total contract dollars amounted to $305.6M, with a savings of $312.4M over projected totals for Government performance.

In a 26 August 1981 study of 18 selected DoD conversions to industry performance, the GAO found that price increases or performance problems normally did not occur. Price increases which were noted were generally deemed to be justified based on additional Government requirements or other contract changes. Projected savings in these contracts totalled over $24M, while total contract dollars amounted to over $66M.

The authors of the book *Better Government at Half the Price* — in surveys of private versus public sector performance of such diverse activities as refuse collection, ship repairs, debt collection and firefighting services — have demonstrated dramatic savings possible by contracting out at the Federal, State and local levels of government. Their findings have led to the conclusion that the cost of public sector performance is generally twice the cost of competitive contract services.

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SUBSCRIBING ASSOCIATIONS

AEROSPACE INDUSTRIES ASSOCIATION

* AMERICAN CONSULTING ENGINEERS COUNCIL

AMERICAN DEFENSE PREPAREDNESS ASSOCIATION

* AMERICAN ELECTRONICS ASSOCIATION

ASSOCIATED GENERAL CONTRACTORS OF AMERICA

* ASSOCIATION OF DATA PROCESSING SERVICE ORGANIZATIONS

* BUILDING SERVICE CONTRACTORS ASSOCIATION INTERNATIONAL

* CONFERENCE OF AMERICAN SMALL BUSINESS ORGANIZATIONS

COUNCIL OF NATIONAL SECURITY COMPANIES, INC.

ELECTRONIC INDUSTRIES ASSOCIATION

HELICOPTER ASSOCIATION OF AMERICA

* INFORMATION INDUSTRY ASSOCIATION

* LEGISLATIVE COUNCIL FOR PHOTOGRAMMETRY

MOTOR VEHICLE MANUFACTURERS ASSOCIATION OF THE U.S., INC.

* NATIONAL ASSOCIATION OF SERVICE INDUSTRIES

* NATIONAL AUDIO-VISUAL ASSOCIATION, INC.

NATIONAL COUNCIL OF TECHNICAL SERVICE INDUSTRIES

NATIONAL SECURITY INDUSTRIAL ASSOCIATION

* NATIONAL SMALL BUSINESS ASSOCIATION/NATIONAL SMALL BUSINESS LEGISLATIVE COUNCIL

NATIONAL TOOL & DIE ASSOCIATION

* NATIONAL UTILITY CONTRACTORS ASSOCIATION

* PRINTING INDUSTRIES OF AMERICA, INC.

* PRIVATE SECTOR FIRE ASSOCIATION

* PROFESSIONAL SERVICES COUNCIL

* TEXTILE RENTAL SERVICES ASSOCIATION OF AMERICA

* EXCLUSIVELY OR PREDOMINATELY SMALL BUSINESS INTERESTS

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